



House of Commons  
Treasury Committee

---

# **Are you covered? Travel insurance and its regulation**

---

**Fourth Report of Session 2006–07**

***Volume II***

*Oral and written evidence*

*Ordered by The House of Commons  
to be printed 20 February 2007*

## The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury and its associated public bodies.

### Current membership

Rt Hon John McFall MP (*Labour, West Dunbartonshire*) (Chairman)  
Mr Colin Breed MP (*Liberal Democrat, South East Cornwall*)  
Jim Cousins MP (*Labour, Newcastle upon Tyne Central*)  
Angela Eagle MP (*Labour, Wallasey*)  
Mr Michael Fallon MP (*Conservative, Sevenoaks*), (Chairman, Sub-Committee)  
Mr David Gauke MP (*Conservative, South West Hertfordshire*)  
Ms Sally Keeble MP (*Labour, Northampton North*)  
Mr Andrew Love MP (*Labour, Edmonton*)  
Kerry McCarthy MP (*Labour, Bristol East*)  
Mr George Mudie MP (*Labour, Leeds East*)  
Mr Brooks Newmark MP (*Conservative, Braintree*)  
John Thurso MP (*Liberal Democrat, Caithness, Sutherland and Easter Ross*)  
Mr Mark Todd MP (*Labour, South Derbyshire*)  
Peter Viggers MP (*Conservative, Gosport*)

### Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk). The Committee has power to appoint a Sub-Committee, which has similar powers to the main Committee, except that it reports to the main Committee, which then reports to the House. All members of the Committee are members of the Sub-Committee, and its Chairman is Mr Michael Fallon.

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) from Session 1997–98 onwards are available on the Internet at [www.parliament.uk/parliamentary\\_committees/treasury\\_committee](http://www.parliament.uk/parliamentary_committees/treasury_committee). A list of Reports of the Committee in the present Parliament is at the back of this volume.

### Committee staff

The current staff of the Committee are Colin Lee (Clerk), Fiona McLean (Second Clerk and Clerk of the Sub-Committee), Adam Wales and Jon Young (Committee Specialists), Lis McCracken (Committee Assistant), Michelle Edney (Secretary), Tes Stranger (Senior Office Clerk) and Laura Humble (Media Officer).

### Contacts

All correspondence should be addressed to the Clerk of the Treasury Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769; the Committee's email address is [treascom@parliament.uk](mailto:treascom@parliament.uk). Media inquiries should be addressed to Laura Humble on 020 7219 2003.

# List of witnesses

---

## Thursday 22 November 2006

<b>Mr Adam Phillips</b> , Vice Chair, Financial Services Consumer Panel, and <b>Mr Frank Brehany</b> , Managing Director, HolidayTravelWatch	Ev 1
<b>Mr Mike Monk</b> , Head of Finance, and <b>Ms Paula Macfarlane</b> , Legal Adviser, Association of British Travel Agents	Ev 6 & Ev 15
<b>Mr Alan Williams</b> , Director, Market and Projects-Services, <b>Ms Jennifer Halliday</b> , Markets and Projects-Services, and <b>Ms Siobhan Furlong</b> , Policy and Strategy, Office of Fair Trading	Ev 11 & Ev 15
<b>Ed Balls MP</b> , Economic Secretary to the Treasury, <b>Mr Clive Maxwell</b> , Director, Financial Services, and <b>Mr Darren Philp</b> , Financial Stability and Risk Team, HM Treasury	Ev 15

# List of written evidence

---

	<i>Page</i>
1 Stephen Pett	Ev 22
2 British Retail Consortium	Ev 23
3 Daniel Tunkel	Ev 24
4 FSA Solutions	Ev 28
5 Association of British Insurers	Ev 31
6 Campaign for Effective Training and Competence	Ev 32
7 Norwich Union	Ev 35
8 Comet	Ev 37
9 Direct Line	Ev 38
10 British Insurance Brokers' Association	Ev 40
11 Financial Services Authority	Ev 41
12 Zurich Financial Services	Ev 43
13 Citizens Advice Bureaux	Ev 46
14 Financial Services Consumer Panel	Ev 50
15 Finance and Leasing Association	Ev 51
16 HolidayTravelWatch	Ev 55
17 Which	Ev 70
18 Civil Aviation Authority: Consumer Protection Group	Ev 71
19 Office of Fair Trading	Ev 73
20 Letter from the Office of Fair Trading to ABTA	Ev 77

# Oral evidence

---

## Taken before the Treasury Committee

on Thursday 23 November 2006

Members present:

John McFall, in the Chair

Mr Colin Breed  
 Jim Cousins  
 Mr David Gauke  
 Mr Andrew Love

Kerry McCarthy  
 Mr Brooks Newmark  
 John Thurso  
 Mr Mark Todd

---

*Witnesses:* **Mr Adam Phillips**, Vice Chair, Financial Services Consumer Panel and **Mr Frank Brehany**, Managing Director, HolidayTravelWatch, gave evidence.

**Q1 Chairman:** Good morning and welcome to our inquiry into the scope of Financial Services Authority insurance regulation. For the shorthand writer, can you introduce yourselves, please?

**Mr Phillips:** I am Adam Phillips, Vice Chairman of the Financial Services Consumer Panel.

**Mr Brehany:** I am Frank Brehany, Managing Director of HolidayTravelWatch.

**Q2 Chairman:** Was the Treasury decision in June 2003 not to regulate the bundled travel insurance market wrong and, if so, why should that decision be reviewed now?

**Mr Phillips:** We welcomed the regulation of general insurance by the FSA. We were concerned about the exclusion of bundled travel insurance and of extended warranties and wrote to Ruth Kelly at the time expressing our concern. Essentially there were two areas where we were concerned. One was the high price of these insurances which we think reflects lack of competition in the market; the other one was the difficulty of consumers getting clear advice about these products. We continue to be concerned.

**Q3 Chairman:** Is there any concern that by extending the scope of FSA regulation to the bundled travel insurance market (and possibly the extended warranties market), that the organisation will become a less effective or less focused regulator?

**Mr Phillips:** I do not see why it should; that is really not a question for us.

**Q4 Chairman:** What evidence exists of consumer detriment in the bundled travel insurance market?

**Mr Brehany:** The evidence from our perspective is witnessed through the calls we receive at our helpline and through our website. You will no doubt have seen from the report that there are a number of issues which have been raised by clients' experiences but also from our own mystery shopper experience. If I were to look at it from the consumers' individual point of view, there are several concerns that I have, the principal one being that in the recent Court of Appeal decision there is a real threat that the holiday market will now become much more de-regulated. We can see, certainly in the Insure and Go example,

the exclusions for legal expense insurance which is offered to the holidaymaker, puts in now the exclusion, for example, provider of accommodation. There are a lot of tour companies who are now saying, "Well, we only sell holiday accommodation" or "We only sell airline tickets". Therefore a consumer, for example, is buying a travel insurance believing that they have legal expense insurance cover but unfortunately when they come home and look at the exclusions they find they will not be able to use that benefit within the policy to be able to pursue any action that they believe they have against the provider of the accommodation or indeed the holiday. I think certainly other issues arise. There is the discrepancy between, for example, women who are pregnant who travel abroad. There is a range of policies where there are exclusions for people from eight weeks of pregnancy right up to 28 weeks and nobody really can see those exclusions until obviously they need to use the policy. There are also issues that arise from the policies. For example, the Easyjet policy excludes claims for children under 15 who experience permanent physical injury. That is quite important because we have recently heard of a case where a young child has suffered a head injury having gone down an unsupervised slide in a water park in Turkey. I do not know whether that family has this particular policy, but if you follow the analogy you will be able to see that that family would not be able to seek some kind of recompense.

**Q5 John Thurso:** What are the main problems that consumers have experienced when buying travel insurance?

**Mr Brehany:** Certainly from what people tell us and from my own experience, it is actually seeing what you are buying. It is certainly true that you can obtain a very brief summary cover and it will tell you what the benefits are, but you really have to work hard as a consumer to get behind that information. That is certainly well demonstrated if you try to buy, for example, the insurance policy through the internet or if you go into a travel shop or a supermarket.

**Mr Phillips:** To add to that, *Which?* did some mystery shopping this summer on 26 travel agents and it was quite clear that the level of disclosure which the people selling the policies were making was not sufficient for the consumer to make an informed choice.

**Q6 John Thurso:** Your description of it makes it sound almost like a scam; it is slipped in and when you come to need it, it does not have any of the protection that is offered. Is it as bad as that?

**Mr Brehany:** "Scam" is certainly not the word that I would use, but I would certainly want to see more openness. If the product is good enough, just tell people what it is about. One of the issues which I thought was quite positive was when I went on the EasyJet website and tried to buy some insurance there, there was a positive warranty where the holidaymaker or the flight purchaser had to declare very clearly that they had no pre-existing conditions. That is the first time I have seen that and it is the first experience I have had of that, but I would go further to say that it is all very well ticking those boxes but they need to endorse, particularly in this internet age, a much more intelligent case management approach to make sure that people understand this is what they are saying about their particular situation.

**Q7 John Thurso:** Do you think the ABTA voluntary regulation code has made much difference or any difference?

**Mr Brehany:** No, I do not. I think the case examples that I have illustrated in the report, albeit it is only a snapshot and I accept that, are an indication that it is a bit of a toothless tiger.

**Q8 John Thurso:** So for that code to have any relevance it needs to be beefed up?

**Mr Brehany:** I certainly think so, yes.

**Q9 Mr Newmark:** What do you see as the likely impact of statutory regulation on the bundled travel insurance market?

**Mr Phillips:** I think it would greatly improve the consumers' understanding of what they are buying which would be a very good thing to do. I am also concerned about the lack of competition. The problem with bundled insurance at the moment is that you have to be buying it as part of buying something else so if, for example, you think you would like an alternative quote you cannot just go to another high street travel agent, you have to go to an insurance company or broker. Competition is not particularly effective in this market.

**Q10 Mr Newmark:** If FSA regulation resulted in fewer or no travel agents selling travel insurance do you believe consumers would actually suffer then?

**Mr Phillips:** I think there are situations where consumers do need to buy travel insurance at the same time as their travel. I agree, I think it would be a pity if that were to be the outcome. On the other hand, I think that at the present time if you buy insurance which does not cover you then this is a potentially serious detriment.

**Q11 Mr Newmark:** Would the benefits of statutory regulation in this market outweigh the costs? Would statutory regulation enhance market confidence?

**Mr Phillips:** I do not know about the costs. The consumer panel does not have a view about costs; you would have to ask the FSA, but in my view the costs should not be significant in relation to the consumer benefit.

**Q12 Mr Newmark:** How important for consumers is consistency of regulation covering travel insurance sold as part of a package and that sold directly by insurers?

**Mr Phillips:** We think it is very important because we think that consumers have an understanding of how the market works; they believe that all insurance is regulated in the same way and that is not, in fact, the case.

**Q13 Mr Newmark:** If bundled travel insurance is to be regulated by the FSA do you believe it should be with a light or heavy touch, and why?

**Mr Phillips:** I think one of the great advantages or benefits of the way that the FSA is moving with regulations is towards the concept of principles-based regulation and treating customers fairly. Bringing that into the bundled travel market would be a real benefit. I am not sure that that is light regulation but I think it would be a positive development in this area.

**Q14 Mr Newmark:** Could you flesh that out a little?

**Mr Phillips:** I think there is a continuum between light and heavy regulation. I think principles-based regulation is actually a lighter touch because it gives the provider more independence, but if we are describing existing regulation as light touch then I think it is too light.

**Mr Brehany:** I do not believe that the present situation as discussed a few moments ago about ABTA regulation is effective enough. We certainly do not know how many agents or tour operators have been disciplined by ABTA. There is a clear need from a consumer perspective that regulation needs to be certainly beefed up and in my view I would certainly recommend FSA regulation.

**Q15 Mr Newmark:** From Mr Phillips' point of view it is principles-based and fair, and from your perspective it leads to greater clarity and transparency which is not there at the moment.

**Mr Brehany:** Exactly.

**Q16 Chairman:** What might be the insurance implications for consumers of the recent decision by the Court of Appeal clarifying the meaning of the term "package"?

**Mr Brehany:** As you may or may not know, I have written quite extensively on this issue over the last 15 months. The Court of Appeal decision is effectively bad news for the consumer but I actually believe it is worse news for the industry. I think the hint of what is to come so far as travel insurance is concerned is the example that I highlighted a few moments ago in relation to the Insure and Go policy which is

---

**23 November 2006 Mr Adam Phillips and Mr Frank Brehany**

---

the legal expense exclusion for the provider of accommodation. I think what you will see—we are already seeing it within the package market—is that tour operators are now moving away from selling (or overtly selling) a package holiday and moving into the DIY market and that will be reflected in itself within the travel insurance contract as well. The evidence is clear; you can see that happening already within the Insure and Go policy. It will not be long, in my view, before other insurers follow suit.

**Q17 Mr Gauke:** I would like to ask Mr Phillips about extended warranties. What evidence exists of consumer detriment in the extended warranties market?

**Mr Phillips:** I am not aware of much evidence. The OFT has done a little bit of work where there was not much evidence of consumer detriment, but they will talk about that later I am sure. There is going to be a review and it will be interesting to see what comes out in the review. My major concern is that these things are very expensive and offer poor value for money.

**Q18 Mr Gauke:** My next question was going to be what proportion of customers are affected annually by this but presumably across the board you consider it is too expensive?

**Mr Phillips:** Absolutely. There seems to be very little evidence that these products provide people with reasonable value. There are obviously some people who would like this kind of insurance but it does not seem to be possible to buy it at a price which we would regard as reasonable.

**Q19 Mr Gauke:** What has been the impact of the Supply of Extended Warranties on Domestic Goods Order 2005 on mis-selling? Has it been significant?

**Mr Phillips:** We do not know. There was a very small piece of mystery shopping done by *Which?* last year—only 10 mystery shops—which suggested that it may have had some impact but I think we are waiting for the review to see what comes out.

**Q20 Mr Gauke:** Do you think as a model it could be useful in other areas such as the bundled travel insurance?

**Mr Phillips:** I think there is a real difference between the travel insurance market and the extended warranties market. With extended warranties what you get is very clear; it is quite a simple product. In travel insurance there are a lot of issues. Medical exclusions is one example; how far family stretches is another one, or the exact level of cover you are buying. A lot of different elements can be varied and they will affect the cost of the insurance. I think that the model that could be applied in extended warranties certainly could not be applied in travel insurance with much positive effect.

**Q21 Mr Gauke:** Returning to extended warranties, do you think there is a role for the FSA in this area? Is this something where the FSA should have some remit?

**Mr Phillips:** I think there are some benefits in the FSA being involved, particularly in the area of what happens to the clients' money. Where extended warranties are provided by major retailers I am reasonably confident that none of them is going to go into liquidation in the near future, but where you are getting the extended warranty from a manufacturer it is a real issue if that is not backed by an insurance policy. If anything happens to the company you have lost your money. That seems to me to be a potential customer detriment.

**Q22 Mr Gauke:** Given what you have said about extended warranties, do you have any concerns that further regulation could reduce the sales of extended warranties and that that might be of detriment to the consumers, or given what you have said about value for money do you think it would be better if there were few of these?

**Mr Phillips:** I think it would be good to see an increase in competition. The work that *Which?* did last year, this small piece of mystery shopping work, revealed that they were unable to get any other retailer to quote for an extended warranty for something that had not been bought at the retailer. You have actually got quite a problem as a consumer if you want to buy an extended warranty from a different retailer and that seems to me to stop competition working. I think we would like to see an improvement in competition in this market.

**Q23 Chairman:** You made the point about clients' money. Given what has happened to Farepak in the last few weeks are there parallels there?

**Mr Phillips:** Potentially yes. If you buy a product for which you have bought a warranty and it is provided by the manufacturer they are required under the regulation to tell you how your money is going to be protected or guaranteed. They only have to tell you and you then have to take a decision whether you regard that as a reasonable risk.

**Q24 Chairman:** What do they tell you? How do they communicate that?

**Mr Phillips:** They communicate that at the point at which you sign up for the extended warranties.

**Q25 Chairman:** I have actually signed up for extended warranties but I cannot remember how they told me that the money is protected.

**Mr Phillips:** They are required to do that so it must have been somewhere.

**Q26 Chairman:** If it is a case where people worked at counters they do not really get told. It would strike me very much if somebody said, "We'll give you an extended warranty and by the way, Mr McFall, I want to reassure you that your money is okay just in case anything happens to this company".

**Mr Phillips:** I do not think that that is what happens. That is why we would like to see regulation by the FSA of this particular area because it would cover disclosure of key facts.

**Mr Brehany:** There may be a crossover on this point under Regulation 20 of the Package Travel Regulations where effectively the tour operator or travel agent has to account for the money that is held in their possession. Whether that extends into insurance contracts I am not entirely clear on that, but it is certainly worth raising that point.

**Q27 Chairman:** You are experts in this area and there are some big questions being asked here. Could I go back to a point earlier when we were talking about the problems consumers experience when buying travel insurance? I note the MORI survey for Direct Line a few years ago where MORI found out that holidaymakers spend little time discussing their insurance package. The research project showed that over one third signed for their insurance without any discussion; a further 40% spent less than five minutes discussing their insurance package; over a fifth were simply referred to the details at the back of their holiday brochure; over half of all holidaymakers who bought insurance were not asked about the state of health of those travelling, and of those who were asked over a third were not asked to identify specific conditions. How realistic is that of the market still?

**Mr Brehany:** I would say that is very realistic. Taking up the earlier conversation that we had about the ABTA code, for example, there are specific duties under 1.7 of the ABTA Code of Conduct which require the agent or the tour operator to investigate and to guide the holidaymaker into making an informed decision about the product that they buy. I think the reality is—albeit it is not the most scientific approach that I applied—my own shopping experience displayed that there was very little inquiry into what my needs or requirements were. I would certainly support the MORI poll, yes.

**Mr Phillips:** The report that *Which?* did last summer where they contacted 26 travel agents, two thirds of them did not enquire about pre-existing medical conditions and none of them mentioned exclusions or restrictions on the policy during the conversation. I think that supports what MORI came up with.

**Mr Brehany:** The positive point I made about the EasyJet passenger warranty about pre-existing conditions I think is a positive development but that needs to be developed further. When it comes to legal expense insurance a travel agent or tour operator is not going to advise them that they cannot sue them because it would be like turkeys voting for Christmas; they are just not going to do that.

**Q28 Chairman:** Given the size of the travel insurance market, it is very considerable.

**Mr Brehany:** Yes.

**Q29 Chairman:** Something over £600 million a year.

**Mr Brehany:** Yes.

**Q30 Chairman:** How many people now travel abroad from the UK?

**Mr Phillips:** About 60 million trips.

**Q31 Chairman:** If we allow this situation to go on then we are going to find some catastrophic examples down the line, are we not?

**Mr Brehany:** There is no secret in my feelings on this. The potential threat of the Court of Appeal decision on de-regulating the package holiday market I think poses a threat to the travel insurance market as well. I think we are going to see greater problems with holidays and even more problems in the use and application of travel insurance.

**Q32 Chairman:** How many customers do you think do not realise that travel insurance is not a comprehensive product, in other words it is not a life insurance policy or, indeed, a long term health policy when they go abroad?

**Mr Brehany:** I would say that the recognition by consumers as to what they are actually buying is extremely low. I would not be able to put a percentage on it but the problem here is that people are often handed—as indeed I was—a summary of cover and they believe that that is it, that is all they need to consider when they are buying this particular policy. What they do not realise until after the event is that a lot of these policies prevent them from either claiming a particular level of compensation for an injury or indeed pursuing an action against a particular tour operator. I think it is trying to find a way of bridging that divide between the information that is given at the beginning of the purchase of the product and what is actually delivered at the end if they should need that product.

**Q33 Chairman:** It reminds me a bit of the store cards inquiry which our Committee undertook in the last parliament where people go into stores and sign up there and then for a card and there is no time for reflection. It would seem here there is a need for an opportunity for people to really understand what they are doing here and the present situation does not allow that.

**Mr Brehany:** I agree with you and I think there is always the problem of trying to do things for people and introduce the so-called “nanny state”, but this is a large market, there are many millions of people travelling abroad. I think positive steps have to be taken in order to re-enforce the message to the consumer that this is just as serious a product that they are purchasing as indeed the holiday itself.

**Q34 Mr Breed:** Insurance is a good thing because things do happen abroad.

**Mr Brehany:** Indeed.

**Q35 Mr Breed:** There is a feeling that many of the hotels and other holiday accommodation which is provided abroad do not meet the same sorts of health and safety standards that people expect when they go on holiday in the UK. Although insurance may cover things that go wrong, it does not always really compensate for some of the tragic circumstances that occur. In your view, does the British travel insurance industry and those selling

---

23 November 2006 Mr Adam Phillips and Mr Frank Brehany

---

packages abroad make sufficient enquiries to ensure that the hotels and other holiday places meet some of the required health and safety standards so that perhaps there would be fewer insurance claims or fewer people finding that whilst having a tragedy abroad they find themselves not insured for it anyway?

**Mr Brehany:** It will come as no surprise to anyone here that my view would be that there should be clearer health and safety audits as far as hotels and resorts are concerned, but I would also want to present myself and the organisation as being balanced. Certainly there are good tour operators as indeed there are good travel agents and those certainly take their health and safety responsibilities seriously. Unfortunately there are a fair number of organisations that do not and sometimes even the bigger organisations get caught out. If there was a very clear audit trail whereby they could show that there was a good health and safety policy adopted in these resorts or hotels then logically yes, there would be less demand upon the insurance products.

**Q36 Chairman:** You have given us the impression that this is a market that needs further scrutiny and we need to come up with sensible and appropriate policies. Is that correct?

**Mr Brehany:** I would agree, yes.

**Q37 Chairman:** Is bundled travel insurance a different product from travel insurance sold directly by insurance companies, for example annual policies et cetera?

**Mr Brehany:** I am not sure from the consumer perspective that they see it in those distinct lines. It is a question of: "I need travel insurance, where can I get it from? Can it be from the tour operator, the travel agent or on the internet?" and they just see it as one product. I think if you look at the terms and conditions of these policies they are fairly standard terms and conditions. There are variances between each of the products but to the consumer if they get into the policy it is one product.

**Mr Phillips:** What I would say is that by and large annual travel policies are sold as insurance policies in their own right so the consumer is aware that they are making a purchase and the people selling it make some effort to explain what the policy does because they are in a competitive market place.

**Q38 John Thurso:** Picking up that last point that the terms and conditions are standard, is there any merit in having one standard policy that would be the benchmark which the consumer bought and then if they wanted to add or detract from it that had to be made clear to them so there was a kind of norm that you knew you were buying?

**Mr Brehany:** In a nutshell, absolutely. I find it absolutely incredible that in the 21st century there are so many companies out there operating on different wording or standards when there is such a push to harmonisation in different walks of life and different areas of life. The examination that I carried out displayed that there are discrepancies and unfortunately these are not clear from the summaries that are provided to consumers.

**Q39 Mr Love:** Mr Phillips, I wanted to carry on from your previous answer where you said that insurance policies are sold in a competitive market place, et cetera. Are we to presume then that you mean that insurance sold as part of a package does not do those things?

**Mr Phillips:** Absolutely, partly because there is no choice at the point of sale; partly because you cannot buy bundled insurance unless you buy it from the person you are buying the travel from; partly because it is a secondary purchase to the primary reason you are making a purchase which is to take a holiday or to book some travel, under those circumstances your ability to consider what you are being offered is somewhat reduced because it is a secondary purchase. All of those reasons mean you get less consideration, you rely more on the person selling it to you to be honest and fair in the way in which they disclose the details and to make sure that any material issues which may affect your ability to make a claim are made clear to you.

**Q40 Mr Love:** So it is not a competitive market and you do not get competitive pricing?

**Mr Phillips:** No.

**Q41 Chairman:** Do any colleagues want to ask any further questions? No. Is there anything you would like to say to us?

**Mr Brehany:** I think I have addressed all the points that I wished to cover today.

**Q42 Chairman:** It has been a very revealing first session. You have set us up for later sessions. Thank you very much for your time.

**Mr Brehany:** Thank you for inviting us.

---

*Witnesses:* **Mr Mike Monk**, Head of Finance, and **Ms Paula Macfarlane**, Legal Adviser, Association of British Travel Agents, gave evidence.

**Q43 Chairman:** Good morning and welcome. Could you introduce yourselves for the shorthandwriter, please?

**Mr Monk:** My name is Mike Monk; I am ABTA's Head of Finance.

**Ms Macfarlane:** I am Paula Macfarlane, Legal Adviser with ABTA.

**Q44 Chairman:** What is your understanding of the rationale for the different regulatory treatment of bundled versus unbundled travel insurance?

**Mr Monk:** The first thing I want to say is that the policies which are sold by the travel insurance industry are precisely the same policies that are sold by the rest of the insurance industry. The exclusion that was granted when regulation came in recognised the fact that this is not our members' main business and that there was no need for it simply because there was no evidence of consumer detriment. I would suggest to the Committee that that is still the case, despite the assertion of your last speaker. It is very easy for people to make these glib statements but when you ask for evidence of consumer detriment you do not find it.

**Q45 Chairman:** What constitutes consumer detriment? Is it price or factor?

**Mr Monk:** In my opinion the price of a policy is a matter of market forces.

**Q46 Chairman:** I am sorry to interrupt you, but if I pay £50 for my travel insurance and I walk down the road and it is £150 and I am silly enough to pay the £150, that is consumer detriment to me.

**Mr Monk:** There is detriment to your pocket in the sense that you have paid more.

**Q47 Chairman:** That is consumer detriment.

**Mr Monk:** It is, but the real issue for me is, is the policy providing you with the appropriate cover that you need? There is no evidence that travel agents or tour operators are selling products that do not meet that need. In fact, I would suggest they are absolutely ideally placed to give you the product you need because they know what holiday you are going on. They know what cover you need and it is absolutely vital that you get the cover at the point of sale. I heard comments about legal expenses, that for me is not really a significant matter. When you buy travel insurance you are buying a series of covers and I would say in importance they are: the medical cover that you get, the cancellation cover that you get and the baggage cover that you get. That is where the vast majority of claims are going to arise. You need cancellation cover from the moment you have bought the holiday. You need to have that cover at the point of sale. If you take away from the travel industry the ability to do that you are going to cause consumer detriment.

**Q48 Chairman:** Would you agree with the MORI survey then about consumers spending little time discussing the insurance package and the possible detriment there?

**Mr Monk:** Before I joined ABTA I was Finance Director of Accident and General and I can absolutely endorse that. The reality is that regulation will not change that. Regulation will not, of itself, change the consumers' desire to read the travel insurance or any other policy and it is up to the supplier at the point of sale to point out to the consumer what the main points of the product are. The summary of cover is essential; it was kind of belittled by the last speaker but that is really important.

**Q49 Chairman:** So there is nothing that can be done, that is what you are saying to us?

**Mr Monk:** No, there is plenty that can be done.

**Q50 Chairman:** We did the store cards inquiry in the last parliament and as a result of that the number of store cards that were sold went down because people were paying 30% interest rates but they did not realise because they were just getting it there and then. The market has changed as a result of that—even the store card producers have reduced their interest—but you are saying the market will not change in this respect.

**Mr Monk:** I am saying that the consumers' attitude to reading insurance policies will not change simply because they are buying from someone who is recommended.

**Q51 Chairman:** So they are stupid.

**Mr Monk:** No, they are not stupid. Consumers habitually do not read the terms of a policy whether they buy it from a travel agent or from someone who is regulated by the FSA. What is important is that the supplier goes through the points of cover with the consumer, almost in spite of the consumer, to make sure that they do understand and to inquire that they are getting the right cover.

**Q52 Chairman:** In the past you have raised concerns that changes in the leisure travel market have reduced consumer protection. What are the key risks for consumers there?

**Mr Monk:** In terms of going abroad, as I said for me the most important one would be the medical cover to make sure they are properly protected if they are unfortunate enough to fall ill when they are abroad. Cancellation cover is necessary because a lot of things can happen between booking the holiday and going which would make them need to cancel (redundancy for example, or there might be some event in the family that means they have to cancel the holiday). Baggage insurance is necessary because baggage is the area where most claims arise. Although it is not a significant number in terms of comparison with medical cover it is still a significant cover. Can I just say something to you? You mentioned before about consumer detriment, 14% of people who go abroad do not take out travel insurance. I would suggest that if they cannot buy at point of sale that number is going to increase and that is going to cause consumer detriment.

---

23 November 2006 Mr Mike Monk and Ms Paula Macfarlane

---

**Q53 Chairman:** We are agreed on the fact that the existing arrangements in the UK for ensuring financial protection for travellers are in urgent need of reform, are we not? You say that in *ABTA Travel Statistics and Trends 2005* at page three.

**Mr Monk:** I do not think they are in need of any more reform than we are putting in place.

**Q54 Chairman:** You said that; this is your document.

**Mr Monk:** Since that time we have introduced a range of measures. Our Code of Conduct has been beefed up; we have introduced compulsory training for all of our members (and that is open to non-members) and we have had over 50,000 people go through that training regime. We are doing all we can to bring up the level of competence.

**Q55 Chairman:** Is there a significant risk associated with travel insurance bought from travel agents who are not ABTA members?

**Mr Monk:** Of course I do not have control over non-ABTA members but our training regime is open to non-members.

**Q56 Chairman:** As an expert observer of the industry, is there a risk?

**Mr Monk:** There is always a risk in any industry but our training is open to non-ABTA members. In fact we have had insurance brokers taking the exam.

**Q57 Chairman:** But there is a risk.

**Mr Monk:** There is always a risk.

**Q58 John Thurso:** Following up on the risks, is one of the major risks to travellers purchasing in the DIY market the fact that the vast bulk of their flights are not covered by bonds of any kind?

**Mr Monk:** That is not a matter of travel insurance, but yes, you are absolutely right. In terms of consumer financial protection the market in the round I would say needs a complete overhaul. Yes, I would agree with that.

**Q59 John Thurso:** Can I ask you what action ABTA has taken to promote the good practice in the sale of travel insurance?

**Mr Monk:** The first thing is that it is now a requirement in our Code of Conduct that all staff or members who are involved in either selling or advising have to take and pass our examination which is a City and Guilds accredited scheme. There are two levels; I will not bore you with them but we have brought copies of the material if you would like to see it. We take it very seriously and our members take it very seriously. At the end of the day these are their consumers. They want to look after their consumers just as much as the insurance industry does.

**Q60 John Thurso:** Given the many thousands of members you have, it is a statistical fact that there is bound to be somebody who does it wrongly or badly, how many of your members have been fined under your disciplinary procedures?

**Ms Macfarlane:** We have worked hard to enforce the Code to make sure that our members go through the exam and what they have done this year is to set up a system where we can see that all of our members are complying and going through the exam. We got in touch with all our members and made sure they were complying. In September of this year we got down to 16 companies that did not respond to us, did not tell us what they were doing and did not appear to have done the exam. We placed those before a disciplinary committee and they were all fined for breaching the Code of Conduct. We published those decisions and they were in the trade papers. That was the most important point, to get through all of those companies. We are looking at the next phase now; we are going into more detail so, for example, ABTA members who have told us that they do not sell travel insurance so they do not need the exams we are now mystery shopping those and making sure that that is all accurate. We are going through different phases of enforcing the code but we have taken it very seriously.

**Q61 John Thurso:** Does the code have to meet any externally determined standards or criteria at present? In other words, it is entirely your internal code or has it been validated in any way in the exterior?

**Ms Macfarlane:** It is our internal code. When we put the code together we had involvement from Trading Standards and we make sure that Trading Standards are also involved in our disciplinary process when cases are heard. It is put together by the membership and it is the code that applies to ABTA members.

**Q62 John Thurso:** I know you heard the previous witness describe the code as a bit of a toothless tiger and I saw you shaking your heads vigorously at that. Has the ABTA code made any measurable difference to consumers?

**Mr Monk:** There is no doubt that it does. It covers a whole range of things; obviously travel insurance is but a very small part of the code. Last year the committee levied fines of over £62,000 against our members, it is certainly not a toothless tiger. There is the power to regulate the members not just in terms of fines but in terms of expulsion.

**Q63 John Thurso:** Has anybody been expelled?

**Mr Monk:** Yes.

**Q64 John Thurso:** How many?

**Mr Monk:** Not that many. I have been at ABTA 12 years and I think it is probably only about three or four because obviously it is not something we are keen to do. We would much rather have these people within ABTA acting properly than outside of ABTA where we have no control over them. I have seen members fined six digits before for serious breaches of the code. It is proportionate to the offence and the entity before us. Obviously a fine of a thousand pounds to a major international company is of less significance than to a family company with one branch for example. They do have to have some account of that too.

**Q65 John Thurso:** Turning round what we heard before and asking you for a positive contribution, why is it not possible to have an absolutely standard product that is, if you like, regulated, clearly stated, the consumer knows precisely what they are buying and the onus is only if you wish to deviate from it to make clear what the deviation is?

**Mr Monk:** To be honest with you, I think the notion of a standard insurance policy is somewhat bizarre. We are entering into competition areas now and there are a lot of people in the market supplying different policies and they all seem to differentiate one from another in terms of the cover they give, the limits, the exclusions. What is important is that the consumer is given the right policy for the holiday that they are about to embark on.

**Q66 John Thurso:** Forgive me for interrupting, but there is something called third party, fire and theft which then moves up to comprehensive. Why can we not have a third party, fire and theft insurance and then allow people to buy on from that?

**Mr Monk:** You heard the last speaker say that most of the policies are broadly the same and they are broadly the same because they have evolved to cover most of the needs of consumers. The only issue is when, as a consumer, you are doing something out of the ordinary. For example, if you are going skiing then you do not want to be buying a standard policy, you need to be getting one that covers winter sports. You have to look at all these kinds of things but broadly the policies are pretty much the same. Yes, they have different limits; some of them frankly are artificial. If you look at the medical cover some people give cover of five million, some give 10 million. Frankly, I have never seen any claim anywhere remotely near that; you do not need anything more than a million. They are marketing tools but in the main the policies are standard. Looking at the edges in terms of excesses, you can waive the excess for an additional premium on most policies, so to some extent you can, if you like, move up the chain by paying an extra premium.

**Q67 Kerry McCarthy:** The Treasury is obviously looking at whether they should introduce statutory regulation for the bundled travel insurance market. If they did decide to go down that path what would be the impact on travel agents?

**Mr Monk:** I have absolutely no doubt that if it is the same regime that applies at the moment the vast majority of travel agents will just stop selling travel insurance because they simply will not be able to deal with the addition in compliance cost of being regulated by the FSA. I think there will be serious consumer detriment caused if people do not have the choice of buying an insurance policy at the point of sale. For a start they will automatically not have cancellation cover until they go and get it elsewhere. Many of them will not do it. The 14% that I described earlier who are currently travelling uninsured will, I have no doubt, increase. Can I just correct something that the previous speaker said. A consumer has the right to go and buy travel insurance wherever they like. It is only travel agents

that are constrained. Travel agents and tour operators cannot sell insurance unless it is connected to the supply of travel arrangements. Someone who is regulated by the FSA, for example, can sell travel insurance. If a customer does not want to buy travel insurance from the travel agent they can go and buy it elsewhere so it is a nonsense to say they do not have consumer choice because they do.

**Q68 Kerry McCarthy:** You say, quite categorically, that the travel agents would just stop selling travel insurance. Surely that depends partly on whether the FSA would decide to adopt a light touch or how heavy the regulation is?

**Mr Monk:** Yes.

**Q69 Kerry McCarthy:** Presumably travel agents are doing this because there are quite significant profits for them in selling the travel insurance. What sort of analysis have you done as to the potential costs?

**Mr Monk:** It is true that travel agents do make a profit from selling travel insurance and so do insurance companies. I do not see that that should be regarded as some kind of sin; they are in the business to make money. Obviously they also want to make sure that their consumers are properly protected. I can only quote to you people who are currently regulated, the things they are saying are about the cost of regulation, the burden of regulation, that it has created additional expense and bureaucracy, and travel agents work on very thin margins. An average travel agent's net profit is 1%. If you give them additional compliance costs they will do all they can to move away from that and I have no doubt that certainly the lower quartile, probably the lower half, will stop selling travel insurance and look to other means. They will probably become what are called introducers, in other words they will simply tell their customers that they should contact a particular supplier of insurance to get cover.

**Q70 Kerry McCarthy:** Would they not simply incorporate the extra costs of selling these policies into the cost of the policies themselves? Consumers who decide when they are buying a holiday to buy travel insurance there and then are probably not doing a comprehensive shopping exercise in which they are comparing the cost of doing that with going out and buying it elsewhere, so to some extent they are a captive market. Are they really going to take their custom away if a few extra pounds are put on to cover the cost?

**Mr Monk:** We must not do consumers a disservice; I think they are far more savvy than we realise. If you try to sell someone an insurance policy at a hugely inflated cost they will know and they will go elsewhere. It is a hugely competitive market. Frankly we cannot have it both ways. If price is causing consumer detriment, an increase in price must be more of a consumer detriment. For me the big issue is that the number of uninsured will go up; I have absolutely no doubt about that.

---

23 November 2006 Mr Mike Monk and Ms Paula Macfarlane

---

**Q71 Kerry McCarthy:** You state that so categorically, but what analysis have you done to make you reach that conclusion?

**Mr Monk:** I say that simply because as well as being at ABTA for 13 years I was at Accident and General for 12, and I know full well that if you do not get consumers to take out insurance there and then a proportion of them simply will not do it because they will forget or they will not find time to do it. In any event, they are losing out on this important time frame where they have cancellation cover. If you let them out of the shop and they are not covered for cancellation, if they have an accident on the way home they are not covered. If they are made redundant the following week they are not covered. That is going to cause considerable detriment.

**Q72 Chairman:** So you are saying the consumers' attention span is very limited. I was a teacher and that is the sort of thing we used to say to kids, that we needed to enlarge their attention span.

**Mr Monk:** I do not put it in those terms. What I am saying is that the holiday experience is a very pleasurable one, they are all excited and insurance is the last thing on their mind but it is so important that they have that cover.

**Q73 Chairman:** I think you are doing a bit of injustice to consumers; I think they have longer memories than you think.

**Mr Monk:** I hope you are right.

**Q74 Mr Love:** You have made a number of assertions this morning, but is that based on any research that you have done? Have you made any estimate of the likely cost of regulation of this particular type of insurance and how robust would any research that you have done be?

**Mr Monk:** I have had to make an assumption first of all that if the exclusion was removed that the regulatory regime would be the same as it is now. If it is the same as it is now then the fees are payable to the FSA based on turnover, and so obviously for different members the fees would be different. When the regulations first came out we did have a review of the average cost to a member and it is in five digits for many of them; that is a very significant number. As I say, it is not just the actual fees, it is the compliance and the burden that will be placed upon the members for what is a short term but very important policy. It is not the same as a life insurance policy; it is a specific policy covering specific risks for a specific time frame.

**Q75 Mr Love:** You have emphasised that point several times. I take it from your answer that there has been no robust research carried out about the costs. Let me be clear about the second thing you said. Originally you were saying that it was the compliance costs that were going to be the major determinate of travel agents' attitude towards regulation and then you went on to say towards the end that it would be the FSA fees. Which one is the more important and of greater concern to ABTA?

**Mr Monk:** I think we have such a mix of membership that it would be different for different people. For a small family company that has maybe three employees, both would be really serious. The compliance costs and the fees would be a serious issue. As you move up the food chain and start getting to the larger companies, the Thomas Cooks of this world, the compliance costs would be less of an issue because they have staff and systems that would be able to cope with that. Again, I think you are going to distort that market and you are going to prejudice the small businesses. Of our 1,600 members 1,400 are SMEs (I describe that as people who turn over less than £15 million). It would be very significant for them.

**Q76 Mr Love:** Let me go on to ask you whether this will all be passed onto the consumer anyway. What is the attitude of ABTA and of your members towards how they would deal with any additional costs that arise from regulation?

**Mr Monk:** It is a matter for them. We do not get involved in commercial matters of that type. At the end of the day they are in business to make a profit and yes, if they have additional costs they have to deal with that in one of two ways. Either they incorporate the cost in the price of the product or they stop the cost by stopping selling insurance which is, I think, what will happen.

**Q77 Mr Love:** Let me put it to you very bluntly. Is it really likely that they are not going to wish to continue to make those profits and leave the market place altogether? Frankly, is it not more likely that they will simply add the cost of any regulation or fees to the FSA to the overall cost of the package holiday?

**Mr Monk:** I think some will do that and some will not do that. As I say, the notion that they are making huge profits from travel insurance is false. It is absolutely true that some members—especially the larger ones, I have to say—are selling insurance products at a rate higher than you can get elsewhere, but a lot of travel agents give insurance away free.

**Q78 Chairman:** Paula, as Legal Adviser, what might be the insurance implications for consumers of the recent decision by the Court of Appeal clarifying the meaning of the term “package”?

**Ms Macfarlane:** We do not know exactly what the impact of that decision is going to be. It was in the first instance concerned with sales by a travel agent and this notion that every sale of different components made to you by a travel agent was a package holiday that had to be financially protected, so it was on that point initially. I have to say that I do not have any particular comments at the moment on what it might mean until we see how it really affects the market.

**Q79 Chairman:** *The Solicitors Journal* of 24 October 2006 said that ABTA believed this crucial decision underlines that ATOL Regulations do not meet the need for consumer protection in today's market. Is that correct?

*Ms Macfarlane:* Yes.

**Q80 Chairman:** So what other things need to be done then?

*Ms Macfarlane:* That is right, and we are working on trying to change the market for a consumer financial protection.

**Q81 Chairman:** In what way are you trying to do that? Is it confidential at the moment?

*Mr Monk:* Not really, no. As you know consumer financial protection is provided in the UK in a number of different ways, the ATOL Regulations are but one of them. ABTA has a scheme of financial protection and there are statutory requirements under the package travel regulations. Package travel regulations are being reviewed currently and we are discussing that with the DTI. Our view is that consumer financial protection in the round—I will not just confine myself to the ATOL scheme—needs to be overhauled because most of the regulations are from 1991-92 or before. The industry is a completely different industry now with the internet and the different routes to market which people have. It is disjointed; it is confusing; the consumers certainly do not understand it, indeed most of the trade do not understand it. That is evidenced by the fact that we and the CAA had to go to court to have a definition of what is a “package”. That is pretty fundamental if, after 11 years (15 years in the case of Package Travel Regulations) we still do not know what “package” is. That is symptomatic of a very serious problem.

**Q82 Chairman:** You are telling us that it is disjointed and confused and there is a huge task ahead of us and Parliament needs to get a grip of this as well.

*Mr Monk:* Absolutely, and I wish they would.

**Q83 Mr Love:** On the issue of the Court of Appeal decision, what are the insurance implications of that decision?

*Mr Monk:* I do not think they are as severe as you might imagine. The implications in terms of the Package Travel Regulations, absolutely. Package Travel Regulations require the organiser of a package to put in place considerable financial protection and to make sure consumers are aware of the need for insurance. Anyone who is now supplying something that is not a package is not constrained by the terms of the Package Travel Regulations, and more and more holidays will be provided not on a package basis. Now the Court has made it clear I am sure this is a business opportunity for people to release some of the ATOL burden. I can tell you, for example, that there were roughly 7% fewer package holidays sold in 2005 than there were in 2004 whereas there has been an increase in the number of independent holidays, so it is a very serious issue both in terms of insurance and regulation.

**Q84 Jim Cousins:** People often jokingly say that Prague has survived two World Wars and two revolutions but the stag party has done for it. I am

very concerned about your statement that 14% of people going out of the country do not have any insurance cover. Do you have any evidence of the kinds of problems that lack of cover produces?

*Mr Monk:* There are all kinds of problems. If you go abroad uninsured and you are taken ill the consequences could be absolutely catastrophic. If you go to the States, for example, and you are taken ill the medical bills that you are likely to be faced with—assuming you can get treatment—are crippling. In human terms you cannot put a figure to that. Obviously there are matters of pure finance, for example if you lose your baggage but you recover from that.

**Q85 Jim Cousins:** Who do you think has the responsibility for warning people about lack of cover? The Committee this morning has been very concerned about who warns people about the quality of cover, but who has the obligation to warn about the lack of cover?

*Mr Monk:* I have always taken the view that consumers have a role to play themselves; you cannot exclude them from this. For me, anyone who is supplying the trip—be it the flight provider, the tour operator supplying the holiday, the travel agent, the internet site—I would really like to see that all of those suppliers put up some kind of warning. In fact ABTA travel agents and ABTA tour operators are required to do that and although we cannot force them to do this we do advise all of our members that if someone refuses to take out insurance they get them to sign an indemnity. We do that for two reasons, firstly to protect the member in the event of a dispute later on, but actually—there is a slightly more subtle reason—many consumers, when faced with a document where they are signing an acknowledgement, will actually recant and take out the insurance because they realise how serious it is. At least half of the people who are given that document to sign will then take out the insurance. On the internet it is obviously more difficult; you cannot force people to take out insurance. I would like to make it compulsory but that is not legal so we cannot do that. I think the supplier should do all they can to get the message across.

**Q86 John Thurso:** You say you cannot force them but I understand that all the cruise liners operating out of the UK actually have a policy that they will not take a booking unless you provide your insurance details.

*Mr Monk:* Many tour operators do that. They will ask that you either take out an insurance which they have or you show them that you have taken out a policy elsewhere to at least the same standard. What you cannot do, when someone goes into a travel agent is say, “You must take out insurance otherwise I am not going to sell you this product.” A tour operator selling his own product or a cruise company selling their product can make it a condition of the contract.

**Q87 Chairman:** Are there any other points you wish to bring to our attention?

---

23 November 2006 Mr Mike Monk and Ms Paula Macfarlane

---

**Mr Monk:** Obviously I would say this, I represent the travel industry.

**Q88 Chairman:** This is your advertising plug, is it?

**Mr Monk:** It is not really. What I want to say to you is that my view is that the number one underlying thing we should all be addressing is consumer detriment. There is no evidence of consumer detriment. I asked the Treasury to tell me what evidence they had since regulation came in; they only gave me two cases and neither of those were mis-selling. The other point I would make is that if you

look at what the ABI say, if you look at what Paul Boateng said in a recent statement, if you look at what the people who are regulated say, the burden is enormous of FSA regulation and there is no evidence of consumer detriment. That is what we should be focusing on. Why fix something that is not broken? I am suggesting that regulation will cause consumer detriment.

**Q89 Chairman:** With that flourish, can I thank you for your evidence.

**Mr Monk:** Thank you very much.

---

*Witnesses:* **Mr Alan Williams**, Director, Markets and Projects—Services, **Ms Jennifer Halliday**, Markets and Projects—Head of Reviews, and **Ms Siobhan Furlong**, Policy and Strategy, Office of Fair Trading, gave evidence.

**Q90 Chairman:** Good morning and welcome to our evidence session. Can you introduce yourselves for the shorthand writer, please?

**Mr Williams:** Good morning. My name is Alan Williams from the Office of Fair Trading. My role is Director in our section which deals with the services markets.

**Ms Furlong:** I am Siobhan Furlong. I work in the Enforcement Division in the Office of Fair Trading.

**Ms Halliday:** I am Jennifer Halliday and I am Head of Reviews.

**Q91 Chairman:** First of all, based on the OFT's experience of other markets, what factors should be taken into consideration when deciding whether to move to statutory regulation?

**Mr Williams:** Our overall aim is to make markets work well for consumers and in doing so our starting point is that it is best if the market is thoroughly competitive. In general, we would want to rely on general competition legislation and general consumer protection legislation rather than specific regulation. If specific regulation were to be an issue we would want to be quite clear that the benefits of it outweigh the costs and that it was proportionate to the detriment that had been identified because regulation does have costs and it also sometimes suppresses competition so it might in fact have no benefit at all overall. It does vary very much from market to market.

**Q92 Mr Breed:** The Extended Warranties Order has been in force for about 18 months now. Have you been able to make any assessment of the effectiveness in terms of the Extended Warranties Order in the way in which they are then sold by electrical retailers?

**Mr Williams:** We have not done that in a systematic way at all yet but we will be doing that next year. We have done some on-going monitoring and there is some evidence to suggest that there are some concerns that it is not working completely, on the other hand there is also some evidence that things have got better. It is a bit mixed so I would not like to make any overall judgment ahead of our full review next year.

**Q93 Mr Breed:** What sort of time next year might you be doing that?

**Ms Halliday:** It will not be until the second half of next year. It is quite early for us to review an order. Two years is quite quick. We are under a duty to review the orders or the undertakings from time to time. It is left to our discretion, so it will be in the second half of next year. As Alan says, we do monitor and enforce as we go on and the information we get from monitoring and enforcement feeds into the review process.

**Q94 Mr Breed:** I understand that the London School of Economics has been doing some work. Have you had any preliminary findings from that as yet which might assist us in our report?

**Ms Halliday:** I think it is too early. I think they have picked a time which is particularly fast moving for extended warranties. People buy a lot of electrical goods around Christmas time and they will be quite surprised with the amount of data that they are going to have a look at. We are only in the very preliminary stages and they will not be reporting until March.

**Q95 Mr Breed:** So far we are told that there has only been one complaint about a breach of the Extended Warranties Order. Does that demonstrate its effectiveness so far?

**Mr Williams:** It is difficult to say. It is obviously not a flood.

**Q96 Mr Breed:** It is not even a trickle.

**Mr Williams:** It may be that there are more problems out there than people have reported to us. We cannot rule that out.

**Q97 Mr Breed:** Are you aware of any sort of complaints that have been received by either yourselves or Trading Standards which relate to the whole issue of these extended warranties but may not necessarily relate to the Order itself? Are there surrounding problems?

**Mr Williams:** Through Consumer Direct there have certainly been quite a lot of complaints about extended warranties in general, but when you look

at these they do not seem to be about the issues covered by the Order, they are more about being disappointed with the service they got under the extended warranty and that kind of thing.

**Q98 Mr Breed:** Many of these would amount to what we have been talking about this morning, consumer detriment.

**Mr Williams:** I guess you could say so, yes.

**Q99 Mr Breed:** How were they not included in the original Order?

**Mr Williams:** The original Order only did certain things. It required the price of the extended warranty to be clearly displayed; it required the consumer to be told when he was offered the extended warranty what his options were; it required a cooling off period so he could later change his mind. It only did these things so it is not everything that people might be concerned about.

**Q100 Mr Breed:** But you can see the thrust of what we are getting at. You have one breach of the Order and yet we are aware that there are a number of issues which are outside of the Order. I do not think I will press the point. How has the OFT or the Trading Standards enforcement of this Extended Warranty Order worked on a practical level? Have you found that there have been problems in trying to enforce it or has it been working perfectly well but not produced anything particularly significant?

**Mr Williams:** As I say, we have found some evidence that it is not working completely well but I do not want to pre-judge the outcome of the review.

**Ms Halliday:** If we did have a clear case of a breach we, as in the OFT, or the Competition Commission or any person affected by that breach can apply to the civil court for an injunction or an interdiction to force the party to comply with the order. Again you would have to establish that there has been a breach of the order and, as Alan says, although we recognise that there have been quite a lot of complaints in terms of Consumer Direct, in terms of the Order itself, which is limited to addressing concerns identified in the Competition Commission report, then there is a different mandate. The Order is predominantly to do with the way these things are sold whereas a lot of the complaints are to do with the coverage that the extended warranty gives, or the issue that was mentioned by some gentlemen earlier in terms of the fact that a company may go bust that has provided that extended warranty and then the consumer may not have the redress and that is not covered by the order.

**Q101 Mr Breed:** After your review next year, if you consider that there needs to be some further typing up or new arrangements will you be bringing that forward for additional work to be done to ensure that will be introduced?

**Mr Williams:** Yes, that is one of our options, that is right. If we considered that there were problems which went outside the existing order, what we

would have to do is to refer the market again to the Competition Commission for a new review. We could not ourselves extend the Order.

**Q102 Jim Cousins:** Are Trading Standards officers under any obligation or do they have any guidance to report to you or indeed to anyone else about the work they are doing in this field?

**Mr Williams:** There is no obligation to report to us because, of course, they are local authority services and therefore usually independent of central government. We do, of course, attempt to get as much information from them as we can.

**Q103 Jim Cousins:** Trading Standards officers are constantly acquiring more and more duties. Does anyone know what they are doing about the exercise of this duty?

**Mr Williams:** Which particular duty?

**Q104 Jim Cousins:** Their duties under the extended warranty scheme to police it.

**Mr Williams:** I think it ought to be fairly clear to them that if they find a breach they should report that to us.

**Q105 Jim Cousins:** Here we have the poor old Trading Standards officers who, in addition to all the other things they have to do, have to do this as well and really no-one knows what they are doing about it. You do not know.

**Mr Williams:** I could not say what proportion of time they are spending on it, no.

**Q106 Jim Cousins:** You do not ask them, do you?

**Mr Williams:** Not to my knowledge.

**Q107 Jim Cousins:** Are the voluntary codes of conduct that have been introduced subject to some external validation or performance criteria?

**Mr Williams:** Are these the OFT approved consumer codes?

**Q108 Jim Cousins:** Yes.

**Mr Williams:** Yes, we do indeed validate them.

**Q109 Jim Cousins:** What does that demonstrate?

**Mr Williams:** It means that the code both has the elements in it that we consider necessary for a satisfactory code and the organisation which is responsible for the code is enforcing it.

**Q110 Jim Cousins:** Do you have any published reporting on what is happening about the implementation of the code?

**Mr Williams:** Only when we think that something has gone awry, for example.

**Q111 Jim Cousins:** So far you do not.

**Mr Williams:** There was the recent case where ABTA withdrew from our approved code.

**Q112 Jim Cousins:** We are in a situation where you have introduced your voluntary code and you really have no objective measure of what is happening

---

23 November 2006 Mr Alan Williams, Ms Jennifer Halliday and Ms Siobhan Furlong

---

under it. We have laid an additional duty upon the Trading Standards officers and we do not know what they are doing about that.

**Mr Williams:** There are two different things there.

**Q113 Jim Cousins:** Of course, yes, but we do not know about either of them.

**Mr Williams:** We have not done any research on what Trading Standards are doing on extended warranties.

**Q114 Chairman:** Could you do some research on it? We invite you to do some research on it.

**Mr Williams:** We will certainly consider it.

**Q115 Chairman:** OFT came to a committee in the last parliament and on the issue of late penalty charges and others you were way behind the curve because there was a passive role which the OFT took at that time and it just strikes me that a passive role has been taken again here. There is no forward looking agenda. We would like to see some dynamism about your organisation. If you undertook that research and shared it with us it would be really helpful.

**Mr Williams:** I take that point.

**Q116 Chairman:** I will write to your Director-General and ask him if he will do that but you can tell him before the letter comes.

**Mr Williams:** Very well.

**Chairman:** Thank you.

**Q117 Kerry McCarthy:** You have not had any complaints yet about the Foreign Package Holidays Order?

**Mr Williams:** Not about the order, no.

**Q118 Kerry McCarthy:** You have not had any complaints about non-compliance with it so far as you are aware?

**Mr Williams:** Some of the data we get out of Consumer Direct is not easy to interpret. It is possible that there is one allegation of breach there but it is not clear.

**Q119 Kerry McCarthy:** That something which is under investigation at the moment. Have you had more general complaints about bundled travel insurance products or are you aware that local Trading Standards have?

**Mr Williams:** Yes, there have been a certain amount of complaints in general about the whole of insurance but again not about matters covered by the order.

**Q120 Kerry McCarthy:** What are those complaints about?

**Mr Williams:** I am not sure.

**Ms Furlong:** I think they are very similar to the sorts of complaints you get about extended warranties which are what it covers. It is the nitty-gritty of the actual insurance which is what most of the

complaints are about rather than the way they are sold which is what the order covers. It is pretty much very similar to the extended warranties.

**Q121 Kerry McCarthy:** In terms of the complaints about the actual products it is when it comes to the crunch the product has not met the consumers' needs.

**Ms Furlong:** Generally, yes.

**Q122 Kerry McCarthy:** What is your view then on the model of regulation for extended warranties being extended to cover travel insurance by travel agents?

**Mr Williams:** I think we would need, first of all, to take a view which we will not have done until our assessment as to whether it is working in extended warranties. If we do not find it is working there then it certainly would not be a model for anything else.

**Q123 Kerry McCarthy:** In terms of the actual resource and cost implication for the OFT in taking on that additional responsibility if it was extended to travel agents, have you done any analysis of what those implications would be?

**Mr Williams:** Not really, no. We do not have a very clear idea.

**Ms Halliday:** We would not be able to extend it because, as with the case of extended warranty, it is an order and the OFT's function is to monitor, enforce and review it. If we wanted to extend it to something that was outside the ambit of the original Competition Commission investigation (or the MMC in this case) we would have to refer it back because we do not have the discretion to extend regulation. We are just basically a reviewing oversight function for what the CC does. When they do put an order into place there is a Regulatory Impact Assessment done at the time as there was with the Extended Warranties Order.

**Q124 Kerry McCarthy:** It is not done until the actual order.

**Ms Halliday:** When you have a remedies phase basically they will look into different options in terms of remedies for an anti-competitive practice and they will try to weigh up different options. If there is an option which produces the same result which is less onerous and therefore more proportionate then they will obviously go for that one. It obviously depends on the remedies that are available and the ones that the industry are able to comply with and able to accept because there is no point in having a remedy if it is not enforceable or monitorable.

**Q125 Kerry McCarthy:** Are you able to put a figure on the current cost of enforcement for the Extended Warranties Order?

**Mr Williams:** No. We would have to do more work before we could do that.

**Q126 Kerry McCarthy:** Is that something that is part of the current review or is it likely to figure in there?

*Ms Halliday:* The review is basically the substantive assessment of how effective the order has been in addressing the problems identified. It is the annual report, more about resource implications for the OFT.

**Q127 Chairman:** What is your general view of the effectiveness of non-statutory regulation such as voluntary codes of conduct?

*Mr Williams:* It can work quite well. We believe that those areas which are covered by the OFT approved codes generally speaking have worked quite well. It does not always work; it is going to depend very much on how seriously it is taken by the industry concerned.

**Q128 Chairman:** Could you give me an example of where it has worked well and an example of where it has not worked well?

*Mr Williams:* Where it has worked well is the vehicle builders' scheme, the Society of Motor Manufacturers and Traders.

**Q129 Chairman:** Where it has not worked well?

*Mr Williams:* I suppose you could say because ABTA withdrew from it that it did not work well there.

**Q130 Chairman:** You say the ABTA code is not working well?

*Mr Williams:* They withdrew from our approved scheme.

**Q131 Chairman:** So they need something in its place.

*Mr Williams:* They do have a scheme but it is now no longer approved by us.

*Ms Halliday:* One that you might be interested in as well is that extended warranties used to have a self regulation scheme where the industry self-regulated before the big competition inquiry and that was found to be unsuccessful. That was one area where self-regulation in that sense did not work and there was room for statutory intervention. Perhaps the existence of poorly-functioning self-regulation kind of bolsters the need for a more structural solution sometimes.

**Q132 Chairman:** Do you think there is consumer detriment there?

*Ms Halliday:* What do you mean by consumer detriment?

**Q133 Chairman:** You heard the exchange we have had this morning, is the consumer getting a good deal?

*Ms Halliday:* In terms of research that we have done at this stage, all I would say is that all we are concerned with doing, in terms of my role, is to make sure the Order is working effectively to make sure that when they are buying the goods they get the information they need.

**Q134 Chairman:** I am asking the OFT then, is the consumer getting a good deal?

*Mr Williams:* In the extended warranties market?

**Q135 Chairman:** Yes, in travel.

*Mr Williams:* I would like to say that it is best to wait until we have done our review to take a view on that.

**Q136 Chairman:** Do you have a feeling about it?

*Mr Williams:* I feel it is better than it was.

**Q137 Chairman:** Better than it was but it is not quite there?

*Mr Williams:* Possibly not. I am being cautious.

**Q138 Chairman:** I can see that. Do you think that codes of conduct subject to externally determined standards or criteria will be effective? In other words, the external body sets up the rules and then the code has to be observed, that type of model.

*Mr Williams:* Yes; that is how the OFT approved codes work, yes.

**Q139 Chairman:** The current regulation of this part of the market for extended warranties through the Extended Warranties Order, does that fit in with the principle of risk-based regulation?

*Mr Williams:* I believe so. The Competition Commission, when it decided to recommend those orders to the DTI, would have taken a view on the proportionality of the risk that it needed to address in order to balance out what was proposed in the Order with the detriment.

**Q140 Chairman:** Does the OFT have a view that the regulation was proportionate to the risk?

*Mr Williams:* We would not want to second guess that, although of course it will be an issue in our review going forward if we decide that any changes are needed. We would need to consider proportionality and risk there.

**Q141 Chairman:** Going back to the previous question, why did ABTA withdraw from the OFT approved scheme?

*Mr Williams:* They changed their basis for protecting the money of consumers that was pre-payments and deposits, and they changed it in such a way that it was no longer compliant with our guidance.

**Q142 Chairman:** Is there anything you can do about that? Is there any action you can take?

*Mr Williams:* We do not have any power to compel them to change their behaviour at all.

**Q143 Chairman:** So there is a gap here.

*Mr Williams:* Potentially so.

**Q144 Chairman:** You do not see anybody stepping in to fill that gap?

*Mr Williams:* No, I do not.

**Q145 Chairman:** Maybe as a Committee we could have something worthwhile to say about this and investigate it further.

---

23 November 2006 Mr Alan Williams, Ms Jennifer Halliday and Ms Siobhan Furlong

---

**Mr Williams:** You might be able to, yes.

**Mr Williams:** No, thank you very much.

**Q146 Chairman:** Are there any other questions? Colleagues? No. Do our witnesses have anything else you would like to put forward to the Committee?

**Chairman:** Thank you all very much for your time today. Maybe in the intervening period, before the Minister arrives, we can ask the colleagues from ABTA to come back and answer a question.

---

*Witnesses:* **Mr Mike Monk**, Head of Finance, and **Ms Paula Macfarlane**, Legal Adviser, Association of British Travel Agents, gave further evidence.

**Q147 Chairman:** Why did ABTA withdraw from the OFT approval for its code?

**Mr Monk:** What the gentleman from the OFT said was absolutely correct, of course. We amended our scheme of financial protection. I think if you ask the OFT whether our code is effective I am sure that they would tell you that it is. It was on this one matter that we no longer give an unconditional open-ended guarantee that payments made to our members are fully protected. We cannot do that. This comes back to the point I made earlier about consumer financial protection in the round. ABTA is not a statutory body; it is a company, a company limited by guarantee and it cannot put itself at risk by giving this open-ended guarantee which we have done for the last 50 years. Just to clarify, all that we have done is to say that if a consumer goes into one of our members—in particular one of our retail members—and makes a payment in respect of a holiday

booking and that holiday booking is not made (in other words if the travel agent takes money on false pretences) that is a matter for the police, that is obtaining money by deception, and we cannot any more guarantee to pay that money back and we do not guarantee to pay that money back.

**Q148 Chairman:** You have withdrawn from it because of the criminal element of people.

**Mr Monk:** It is a criminal element; this is a matter that should be put through the courts. If a booking is made then the consumer is still fully protected.

**Ms Macfarlane:** It was not to do with the code per se that we withdrew from the scheme; the code does work very well. It was just this small point about financial protection that led to the withdrawal. It was not really to do with the code and how it operates.

**Chairman:** Thanks for that. I am going to ask the OFT back just before the Minister comes.

---

*Witness:* **Mr Alan Williams**, Director, Markets and Projects—Services, Office of Fair Trading, gave further evidence.

**Q149 Chairman:** ABTA have told us that they withdrew just on a minor issue about financial protection. They said the code was effective.

**Mr Williams:** We had no reason to think it was not effective other than on that point but I do not think we consider that to be a minor point. It was sufficient that we would be concerned about a code that did not deal with that.

**Q150 Chairman:** So you cannot say here categorically that it is effective because you are telling me you are concerned about it?

**Mr Williams:** On that point, yes.

**Chairman:** Thank you very much.

---

*Witnesses:* **Ed Balls**, a Member of the House, Economic Secretary to the Treasury, **Mr Clive Maxwell**, Director, Financial Services, and **Mr Darren Philp**, Financial Stability and Risk Team, HM Treasury, gave evidence.

**Q151 Chairman:** Minister, thank you very much for your attendance. We are also grateful for the copy you have given us regarding regulating travel insurance. I know you have a very short comment to make before we ask you questions. Is that right?

**Ed Balls:** Yes, it is as short as possible. I would like thank you for the opportunity to give evidence and just introduce the people who are with me this morning. Clive Maxwell is the Director of the Treasury for Financial Services and Darren Philip who is the Head of General Insurance. As you said,

Chairman, we agreed I could make a couple of remarks at the beginning just to bring the Committee up to date on a couple of issues. Firstly, as you know, the insurance industry more generally plays a vital role in our economy. At the first meeting of the Chancellor's high level group on financial services we agreed an industry-led review to promote market reforms in the wholesale insurance market. I can tell the Committee that today we are confirming that Lord Levine will be joined in conducting this review into wholesale market reform by Graham

Millwater from Willis and Andrew Kendrick from Ace European Group. Those three individuals will be responsible for that market-led review. Your focus today is regulation of general insurance products, the over-arching framework for which is set by the EU's Insurance Mediation Directive. You will know that the FSA is responsible for making the detailed rules of the insurance regulatory regime and it is currently conducting an effectiveness review of general insurance regulation. I understand the FSA review is likely to lead to a more principles-based regime and some de-regulation for those products where market analysis and consumer research shows this to be appropriate. The challenge is in all these areas striking the right regulatory balance between protecting consumers without inhibiting or stifling innovation. There has been a particular concern for us in recent weeks around freight forwarding, an industry which believed they were unnecessarily subject to FSA regulation and following clarification from the Commission on the scope of the directive and, given there is little chance of consumer detriment in that area, we are removing those activities from the scope of FSA regulation under the IMD. I will be consulting on the details of that later in the year. As you said at the beginning, the particular announcements we are making this morning at your Committee are around travel insurance. As you know, under the Insurance Mediation Directive, there are certain types of insurance which can be exempted if they meet certain conditions and currently travel insurance sold along with a holiday—like extended warranties under 500 euros—is capable of falling within the scope of that exemption. When the Government first consulted on the implementation of the IMD in June 2003 it was decided that travel insurance sold as part of a package would not be subject to regulation. This means that currently a product bought through an insurance broker or direct from an insurer is required to be regulated but there is no such requirement for essentially identical products purchased as part of a package. My predecessor committed to a review by early 2007 and in recent years there has been growing concern from consumer groups and sections of the industry that the market is not working as well as it could. For example, a recent *Which?* report found that only 35% of travel agents asked medical questions compared with 81% of banks and insurers who are regulated; only 19% explained what the policy covered compared with 81% of banks and insurers who are regulated; 0% explained what the policy did not cover compared with 56% of banks and insurers. It is clear that there may be an issue here which raises questions about whether regulation and appropriate redress and complaints mechanisms should apply to this area. We need to get to the bottom of whether travel insurance sold with a holiday is being mis-sold. I announced in August that we would be conducting a review into this matter. Today we are publishing a document which we sent to you a couple of days in advance (which has only had one paragraph added to it to explain a little more) which calls for evidence. We are encouraging providers,

sellers and consumers of travel insurance to contribute to that debate. To give you one example, the effects of terrorist incidents: insurance policies covering terrorist incidents abroad and travel insurance may have no exclusions for conventional terrorism risks or have a general exclusion for terrorism risks which is disapplied to some benefits, or have a general exclusion for terrorism risk without any exceptions. According to the Association of British Insurers only around 50% of travel policies cover medical expenses in the event of a terrorist incident. Such policies provide emergency medical treatment, medical repatriation or the repatriation of a body and expenses of family members. Around half of the 20 million travel insurance policies that are sold every year are not providing guaranteed cover for such events. The issue here is about both educating consumers to consider the cover they want when they are buying travel insurance and ensuring that consumers are properly informed. You can see that the Committee's inquiry is particularly timely. We look forward very much to the Committee's input into the debate and consultation which we are currently undertaking.

**Q152 Chairman:** Thank you very much and thank you for sharing the paper. In our previous session this morning we have seen that there are gaps and what witnesses have agreed with is that this is a huge area for change. Do you see what your starting point is? Are you interested in differential regulation, in other words would you contemplate legislative change to enable different approaches to different parts of the insurance sector?

**Ed Balls:** In the case of travel insurance we have differential regulation and I think the evidence is that this is causing some concerns and some problems. Without pre-judging the outcome of the review in any way there are a number of people who are calling in the evidence, including the evidence of your Committee today, for a level playing field, for that level playing field to be proportionate and risk-based but to make sure that consumers also get the protection they need and proper redress. I think in the case of travel insurance we need to look hard to see whether differential regulation is working or whether we need to move to a more level playing field.

**Q153 Chairman:** When John Tyler was here he made the point that there are some areas of the market that are working well, for example car insurance. Then you have, say, PPI or health protection insurance which is not working so well. It is that differential approach to the market we are interested in.

**Ed Balls:** I think the important thing is that we take a risk-based approach. What the FSA are doing currently in their review of their rules in this area is seeing whether we cannot introduce more of the risk-based and proportionate approach. If you are saying, "Should we differentiate the kind of regulation by the kind of product?" then yes we

should differentiate, but should we differentiate essentially the same product in different sales routes I think there the issues are much more difficult.

**Chairman:** You have answered it; it is the former.

**Q154 Mr Gauke:** Minister, are you worried that if you add too many areas of responsibility to the FSA then the FSA will lose its focus?

**Ed Balls:** In my very first meeting with Sir Callum McCarthy he made that point very clearly to me and I understand absolutely that we must not overload the FSA. Already we ask the FSA to cover a very wide range of activities from regulating wholesale global businesses right through to the regulation of what are domestic retail consumer products. This is a challenge for the FSA but it is also, I think, a great strength of our system that we have moved, as far as we can, to unified regulation. If you take the example of insurance, when the consultation occurred around the directive, given that many of the insurance companies were already being regulated by the FSA for potential insolvency reasons, the idea of trying to invent a different regulator to regulate the consumer aspects of their business was something which I think at the time they were opposed to. There is a tension between breadth and the desire to have unified regulation. The fact is that these financial companies, because they are covering a very wide range of business, if we are going to have unified regulation it means that the FSA needs to be able to cover a wide scope of activities.

**Q155 Mr Gauke:** As you say, it already covers a very wide scope. If you add travel agents and if you add high street stores to this it is going to add even more. On sheer numbers of firms that are regulated there has been a massive change in the last two years when you look at insurance brokers and mortgage brokers; this is going to move it further away from the area that the FSA has traditionally covered. Do you accept that that is a major concern that you have to take into account?

**Ed Balls:** In other areas where we have been considering the need to strengthen regulation, for example the implementation of the Anti-Money Laundering Directive and, more broadly, Money Services Business we have had to deal with this issue as well. On the one hand, we do not want, where we can avoid it, to widen the FSA scope unnecessarily (although at the moment the Office of Fair Trading and the HMRC play some role in regulation in these areas). On the other hand, the FSA often has, as I said, the expertise and having either different regulators regulating the same firm or trying to invent new bodies to regulate would also be burdensome for the industry. The particular issue you are raising about travel insurance, the question you are asking probably is whether we need to have a regulatory framework for package sold travel insurance at all. That is what our review is going to look at. Were we to decide that it did, which went beyond simply ABTA self-regulation, then I think there would be a real question as to whether you

would want to try to invent a new regulator as opposed to drawing upon the experience of the regulator we already have.

**Q156 Mr Gauke:** In looking at that first point what I am suggesting to you is that if you start stretching the FSA—I think there is a lot to be said for a unified regulator—eventually the FSA is not going to be able to focus on everything and will make mistakes, things will slip through. You know as well as I do that the FSA management are concerned about this; the last thing they want is something else.

**Ed Balls:** They are rightly concerned about it and we are concerned about it too. Taking the FSA into new areas outside their own scope would be something we would need to think very hard about. In the case of travel insurance they are already regulating essentially the same products as those being sold by package tour companies. The content of the insurance is not fundamentally different so were we to decide to bring those products within the scope of FSA regulation that would not be a new type of activity for the FSA; they are already doing it.

**Q157 Mr Gauke:** It would be a new type of person being regulated by the FSA.

**Ed Balls:** The FSA is already regulating very many thousands of small bodies who are selling financial service products, so it clearly has experience in this area. You are right, it is not regulating travel agents currently and I am not saying that they will. I am not going to pre-judge the review. I have always been clear, we have a genuinely open mind going into this and we could decide on the status quo or somewhere between that and full regulation. I would not like people in the industry to think that we are pre-judging the outcome.

**Q158 Mr Newmark:** Minister, what new evidence has the Government received which might lead it to consider revising its approach to travel insurance and extended warranties? The reason why I ask this is that you have been in power now for well over nine years and clearly it is a dynamic situation and this industry has come in the headlines a number of times with concerns from consumers. What new evidence is there that you have come across that has made you decide to have this step-change in your thinking?

**Ed Balls:** There is evidence arising all the time. The newest evidence I have seen is the evidence submitted to this Committee for the purpose of its inquiry. That is the newest evidence. Slightly older evidence is the *Which?* survey from the summer which I have quoted. I could also refer to the Financial Ombudsman Service Annual Report 2005–06 which concluded: “The policy terms for travel insurance remain complicated and the sales process is frequently limited—given the low value of the transaction involved. As a result, while there is considerable competition on the pricing of travel insurance, there is also widespread misunderstanding on the part of consumers about the scope of the cover they have and the eligibility

criteria that apply". Those are two older pieces of evidence and also the new evidence which I have read in preparation for today.

**Q159 Mr Newmark:** That evidence has been there for a while. Consumers have felt short-changed for a significant number of years. Are you saying that things have got particularly bad recently or is it that now you have decided to focus on this you are now highlighting it as an area that needs change.

**Ed Balls:** I am saying that when this was looked at in 2002–03 a decision was made to go for the model we have currently. The most recent evidence that I have looked at, for example from the Ombudsman, for example from *Which?*, for example in the different industry submissions which have been submitted to your Committee—

**Q160 Mr Newmark:** Are you saying the 2003 model was a weak model and now needs re-looking at? What are you saying?

**Ed Balls:** I am saying that the right way to make policy is to look at the most recent evidence. I have been the Minister with these responsibilities since May. It was put to me that we have a commitment to a review by early 2007. I asked to see the most recent evidence in order to guide our thinking about what kind of review we should have and the evidence which was presented to me at that time (for example the *Which?* survey and some of the other industry views) was that there are issues here which need to be investigated and that is what we are doing.

**Q161 Mr Newmark:** The FSA see statutory regulation of travel insurance and extended warranties as "super-equivalent", that is a phrase they use. How can this be reconciled with the evidence of consumer detriment and consumer negative impact and the commitment to reduce the regulatory burden? You have always got this tension between wanting to protect the consumer but also wanting to keep a fairly light touch with regulations. How do you balance that?

**Ed Balls:** As I said, the responsibility for Government in deciding scope and the FSA in terms of writing and implementing the rules is always to be conscious, case by case and area by area, in striking the balance between protecting consumers and having the best kind of light touch, proportionate regulation which promotes competition and innovation. You need to do that in a risk-based way and you also need, as policy makers, to always be looking at the newest evidence. There are some people who look at the evidence, for example in travel insurance, and say that the FSA approach could be lighter touch; there are others at the other end of the spectrum who say that unregulated sales of travel insurance disadvantage consumers.

**Q162 Mr Newmark:** I am interested in what you think. What do you think should be the balance?

**Ed Balls:** I think, as I said, that you need to use the best evidence, strike the right balance and the right way for Government to go about these things is to consult, listen and make decisions. If you had

listened to my statement at the outset or if you look at the things I said when we first discussed this issue in August, I made no secret of my personal view. At this early stage of the review I think there are genuine reasons to be concerned. As I said at the time, I bought travel insurance at the end of July and was surprised not to be asked any of the questions one would expect to be asked in the process of buying that travel insurance, for example about medical exemptions or small children. There are many consumers buying travel insurance who are often very busy and I am concerned that they often only find out after the fact that they did not have the cover they thought they would have had.

**Q163 Mr Newmark:** What is your assessment of the effectiveness of the model of regulation provided by the Extended Warranties Order? Might a similar approach be appropriate for regulation of bundled travel insurance? My next question has to do with the assessment that you made of the increase in the costs of regulation. The reason why I ask that is because the ABI has told us that for some sectors of the insurance market (such as motor insurance and home insurance) the cost of additional FSA regulation exceeded the benefits. Do you accept their calculations on this?

**Ed Balls:** On the latter point first, the FSA is looking at its rules and as I understand it the two areas you have just highlighted—motor insurance and household insurance—are two areas where they are looking at whether or not it can move in a lighter touch direction. I completely accept that the ABI is raising an important point which needs to be looked at carefully by the FSA.

**Q164 Mr Newmark:** What do you think about the costs themselves?

**Ed Balls:** It is a matter for the FSA to make those judgments. As I said, I have indicated they are listening carefully to what the ABI say on those matters. In terms of extended warranties, I do not think that people are arguing that there are problems in the current extended warranties regime and obviously we will be looking at the way in which that regime is working to draw lessons for other areas.

**Q165 Mr Breed:** Minister, the use of the Financial Services and Markets Act model in the implementation of the Insurance Mediation Directive has meant that requirements for intermediaries selling insurance have also been applied to direct sales by insurance companies. Can you tell us why that approach was taken and do you accept that this approach has resulted in gold-plating and created extra compliance costs for the businesses involved?

**Ed Balls:** There was extensive consultation about how to translate the IMD into UK regulation and at that time the view of the insurance companies themselves was that having a single regulatory regime which covered both intermediaries and direct sales was a better approach. They did not want to have to be regulated by two different bodies, one for potential solvency reasons and a second for sales. As

---

23 November 2006 Ed Balls, Mr Clive Maxwell and Mr Darren Philp

---

I understand it, that was the outcome of the consultation at the time and I think most sensible opinion thinks that that was the right model but we need to make sure that we do not implement it in a burdensome way.

**Q166 Mr Breed:** Is that being looked at to see if they can perhaps reduce some of the costs?

**Ed Balls:** I think the FSA at the moment is precisely looking in its effectiveness review to see whether or not it is doing as much as it can to be risk-based and proportionate, but I do not think there is any question about reversing that fundamental principled decision about unified regulation.

**Q167 Mr Breed:** To what extent has the regulatory burden put the UK general insurance market at a competitive disadvantage compared with European counterparts?

**Ed Balls:** It is a matter of frustration to the UK that other European countries have been slow to implement the IMD. I think it is still the case that one large Member State has yet to implement the IMD and that is not good enough. We have taken action to contact the Commission to urge them to accelerate progress. This is an area where the issue is really about the sale of insurance within the domestic market. I do not think we have evidence that this is doing substantial damage to the industry, but obviously we are concerned about it and more generally we have learned lessons from the whole IMD process. These days we are much more demanding about cost benefit analysis and looking at market-led approaches at the European level before agreeing directives. The IMD was not a state-of-the-art directive.

**Q168 Chairman:** Going back to a point you made earlier, did you say that there were no problems in the extended warranties?

**Ed Balls:** I said that that has not been put to us.

**Q169 Chairman:** You are aware that the OFT and the London School of Economics are doing a major research project next year on this so there has to have been something which has come to the OFT for them to have undertaken that.

**Ed Balls:** We decided to implement the warranties exemption with the exception of motor insurance, but as you know there has been a broader issue around competition policy and extended warranties and in my previous time in the Treasury we were always very keen that the OFT looked very carefully at the way in which the warranties worked.

**Q170 Chairman:** What I am trying to get at is, is your mind open on extended warranties given that the work is going to be undertaken by the OFT and the London School of Economics?

**Ed Balls:** Absolutely, but I think the competition policy issues are probably where the greatest focus is.

**Q171 Kerry McCarthy:** We have taken a fair bit of evidence as a Committee in the past about the move away from detailed rules-based and towards principles-based regulation. Some concerns have been expressed that smaller firms in particular—because they do not have the ability to challenge the FSA—would feel quite uncomfortable with a principles-based regime. What is your view on that and, particularly if you are looking at extending FSA regulation to travel agents, what role do you see the travel industry itself having in trying to draw up those principles, or do you think they need more detailed rules because quite a lot of those firms will be quite small?

**Ed Balls:** As you know there is currently an ABTA code for the sale of non-regulatory travel insurance and any change in the regulatory regime I think would start by looking at that code. If there was to be a change there would need to be extensive consultation. Part of the problem is that ABTA has not managed to get as wide a coverage for the take-up of that code as it may have liked and clearly there is no statutory or non-statutory appeals process with that code. That is really where the problem lies. I understand the point you make that a principles-based regime requires more understanding of intention; it is a more sophisticated thing than simply a rules-based regime but it also works better. The key thing is that it needs to be not only principles-based but also to be risk-based and therefore the focus of intervention needs to be where there are genuine risks arising. It is clearly easier to deal with a principles-based regime when you are talking about large companies in wholesale markets and more complex when you are dealing with direct sales to individual consumers. That is something the FSA is very conscious of I think.

**Q172 Mr Love:** I want to go back to what you said about the balance between innovation and consumer protection. I take your point about the need for evidence-based policy making, but has there been a shift in the balance between those two things in the thinking within the Treasury? We talk a great deal now about risk-based regulation and principles-based regulation; are we thinking in different terms about the balance than we did six months or a year ago?

**Ed Balls:** I do not think we are thinking differently about where the balance should be struck. We may be thinking differently about the best ways to make sure that once you have made a judgment about how to strike the balance you then implement it in a way which is consistent with your objectives. If you take travel insurance for example, on the one hand it is put to us that FSA regulation for some companies may be heavier than it needs to be; on the other hand I am directly raising our concerns that for non-FSA regulated travel insurance, consumers may not be getting the protection that they need. I think it is quite consistent to listen to and act upon both concerns. That does not suggest to me that we are de-emphasising consumer protection.

**Q173 Mr Love:** Clearly there has been a great deal of talk about regulation and de-regulation as an issue. There was a very high profile meeting with a high level group in the City of London where I think some of these issues were discussed. I read the *FT* the other day to discover that the US Treasury Secretary has been commenting in these particular areas. I am just trying to get a view of whether there is a shift going on about that balance and whether, when you come to look at the evidence, you will be looking at it with slightly different criteria than you would have done a year ago.

**Ed Balls:** I note a hint of concern in the question and I think I can reassure you. I was in Tokyo two weeks ago on a panel talking about the importance of light touch regulation. Through the translation my Japanese colleague on the platform then said, "I am concerned to hear the Minister talking about soft touch regulation" and I had to immediately correct him to explain that there is nothing soft touch at all about a risk-based approach to regulation. Indeed, a proper, proportionate risk-based approach is lighter in its touch where risk is lower but clear, direct and heavy when there are risks which are not being addressed. I think one of our concerns about a more ruled-based approach to regulation is that it can be onerous and bureaucratic for firms to implement and at the same time, because it becomes routine, actually less focused on identifying then addressing risk. From the point of view of protecting consumers from risk the approach which we are following allows us to be more clear in our focus on protection where risks arise.

**Q174 Jim Cousins:** Coming directly to a point that you made yourself, do you think the provision or not of terrorism cover in a travel insurance is a matter for markets and market regulators alone?

**Ed Balls:** There are a number of differences in travel insurance products on excesses, exemptions, coverage for dangerous sports, coverage for a sick relative and having to return home. There are a range of products which are on offer and people can make their choice as to what kind of cover they buy depending upon the risks that they perceive, both in their own lives and in the place they are going to. I do not think that regulation needs to specify to consumers how they make those judgments. What regulation is about is ensuring that people have the information they need and are aware of these kinds of issues. If consumers, when asked, "Do you want to have this kind of cover?"—which I believe they should be in cases like medical coverage or medical coverage in the case of a terrorist incident, it seems to me that those are the kinds of questions which sellers ought to be asking—say "Of course" then the market will then very quickly make sure that they are being provided.

**Q175 Jim Cousins:** Are there not some broader issues here that go slightly beyond markets and market regulation? The issue of whether terrorism cover is provided, the issue of whether there is flood protection cover if somebody buys a house in the Thames Gateway, the fact that 80% of furnished

tenants do not have household contents cover, 60% of unfurnished tenants in all sectors do not have household contents cover, are they purely a matter for providers and consumers? Is there not a broader social interest in these things?

**Ed Balls:** In a number of areas of insurance the broader social interest requires the Government to act in law. One example of that is motor insurance where you cannot buy a tax disc and therefore be allowed legally to drive a car unless you have that kind of cover. Clearly there are times when the social interest, because of the impact of an individual's decision on others, requires the Government to act.

**Q176 Jim Cousins:** Externalities.

**Ed Balls:** Yes. There are other areas though where it is a matter for individual choice but it is important that people are aware of the risks that they would run. It seems to me that depending on where in the world you are travelling or depending on the age and health of relatives back at home, individuals might make different choices about the kind of cover they want to buy. We do not need demand that everyone is covered for every eventuality independent of their choice about whether they think those eventualities are real for them, but we do need to make sure that people are properly informed. My fear in the case of the terrorism issue is that people are just not aware of the fact that there is a 50% chance that in the insurance policy they bought it is not going to be covered. I think often the same thing happens with relatives. You only find out after the fact, when you make a claim, that in fact you were not covered. In those instances I do not think we need write the contracts of sale for insurance companies for them but we do need to make sure that consumers are better informed.

**Q177 Jim Cousins:** Surely the fact that one in five of furnished tenants—only one in five—has household contents cover when they are the section of the population that is most vulnerable to the risks that are protected by contents cover, that is a social issue with which we ought to deal, not just an issue for markets and product providers.

**Ed Balls:** There are a lot of examples where you or I may think it is desirable that people take out a particular kind of cover or provision, but whether the state should require them to do so I think is another matter. We have household insurance cover for our house and we encourage friends and neighbours and people more widely to do the same. But should we require people to do so?

**Q178 Jim Cousins:** The fact that only one in five of furnished tenants, the most vulnerable section of the house population, has contents cover is something that ought to give us all huge concern and we ought to be bending our way to reduce that figure considerably.

**Ed Balls:** I may be simultaneously very sympathetic to the point you make and keen to see what can be done while being cautious about new statutory obligations on individuals to take out cover independent of their own judgment.

---

23 November 2006 Ed Balls, Mr Clive Maxwell and Mr Darren Philp

---

**Q179 Chairman:** Would you consider that a nanny state issue?

**Ed Balls:** I would, yes.

**Q180 Chairman:** There are a couple of issues that concern me and one is contract certainty. I found out a couple of years ago that they do not provide policies when arranging insurance and FSA has given the industry two years to correct that situation. I think that is up in December and as it is an issue that this Committee is interested in, could you keep us informed of what is happening in that area?

**Ed Balls:** I certainly will and I am happy to do so.

**Mr Maxwell:** You described what is underway at the moment. I think the markets have been responding to the FSA's pressure on that. There is a recognition that they need to modernise their practices around their contracts and indeed around other aspects of those markets.

**Q181 Chairman:** Commission disclosure is not mandated presently and there are problems there with competition regarding the product provider and the distributor where influential people in the

industry have said to me that the customer has been forgotten about. Is that an issue you could look at for us and report back?

**Ed Balls:** I believe the FSA is looking more broadly at these issues. Clive Briault made an interesting speech following a very interesting speech made by Sir Callum in September. These are issues being brought up by the FSA.

**Mr Maxwell:** Yes, certainly in the case of retail markets.

**Q182 Chairman:** If you could be in contact with FSA on that and find out the latest situation that would be helpful. Minister, thank you very much, first of all, for giving us that paper which is very informative and, also, for this session opening the consultation process. What we want to do is to be able to report to you in January before your consultation period ends so that we can inform the situation. For your attendance this morning and the paper, thank you very much.

**Ed Balls:** I can guarantee that we will study your report and conclusions in detail before we reach any conclusions ourselves.

**Chairman:** Thank you very much.

---

# Written evidence

---

## Memorandum submitted by Stephen Pett

I am an ex insurance broker and IFA, and now editor of a trade Newsletter. I left the industry as the retrospective rule changes brought in by the FSA mean that my entire families financial structure was at risk—forever—however great my personal integrity. Just a totally unjustified complaint could wipe out the value of a client, and if you can not prove your case to today's standards when earlier regulators (who are legally the FSA however much the FSA might deny it) said we only need to keep records for 6 or 7 years.

I have had dealings with the FSA at senior level, and can vouch for the fact that they do not listen to small firms. Their agenda seems to be to confuse the industry with mounds of FSAspeak, changes of policy which (whatever they say) are retrospective. They know all without asking, they do not like consultation<sup>1</sup> in any meaningful sense of the word and they ruthlessly hunt down those who oppose them, as many former advisers will testify. Their new "open" rules are just a trick so that they can't be blamed when anything goes wrong, as they have neither the courage nor the ability to risk rate products, which is what the public and the industry really needs. Meanwhile, the FSA are just interested in headline fines and scandals, which damage the industry locally and internationally costing both invisible earnings and lower levels of protection and investment. They are the playground bully—using brute force and ignorance where subtly and understanding are needed. Indeed, I often wonder if they are being paid by big overseas insurers to wipe the UK industry out so they can take over. It just seems the only logical explanation.

That said, I am sure the big insurance firms and stock market types who have weight and clout and contacts probably find the FSA wonderful and totally responsive.

### 1. *The current extent of regulation of the insurance market*

The current insurance market is regulated by a Regulator which has little real understanding of the market and makes it very clear via its PR department that most of the industry is deliberately or ignorantly dishonest. For the FSA, the whole benefit of the industry is far outweighed by a single transaction which goes wrong: risk is unacceptable, experimentation is unacceptable. Mountains of paper and a whole new layer of (different) jargon imposed by the FSA help no one.

### 2. *The need for, and potential effects of, extending regulation to the bundled travel insurance and extended warranty markets*

Yes these should clearly be regulated, but not by the FSA with their track record of imposing an enormous and (worse) incomprehensible burden on the industry. Unless the plot is to wipe out the industry by regulating and badmouthing it to death.

### 3. *The form any proposed future regulation might take, including models for non-statutory regulation*

The country already has Courts and a Consumer protection system in place. How about compulsory membership of an industry trade body which is required to impose minimum standards in terms of policy cover and service. But please, not the FSA.

November 2006

---

## Memorandum submitted by the Association of British Travel Agents (ABTA)

### ABOUT ABTA

- ABTA is a trade association and an approved body under the Package Holiday/Travel Regulations;
- ABTA currently has over 1,600 members who between them have just under 6,400 outlets;
- ABTA members' combined turnover exceeds £27bn and represents approximately 80% of the package travel market.

---

<sup>1</sup> FSA Consultations are so complex that no firm can deal with them without employing a full time member of staff to understand the language and try to see what the FSA intend—which is rarely obvious.

*How many travel agents currently sell travel insurance and could be brought within the scope of the FSA's regulation?*

There is no official data but our best estimate is that the travel trade is responsible for around 30% of policies issued. MINTEL, HM Treasury and the insurance industry all have their own statistical data. MINTEL has suggested that the size of the market might be around 40 million policies issued, whereas the Treasury has said 20 million.

*Whether there is any evidence of consumer detriment arising from the selling of travel insurance by travel agents?*

There is no evidence of consumer detriment, however, if travel insurance was in the future to be regulated by the FSA our view is that this would, in effect, be to the detriment of the consumer.

If the travel industry fell within the aegis of the FSA, the compliance costs would almost certainly be likely to make the sale of travel insurance uneconomic and this would ultimately result in:

- more consumers travelling without insurance;
- more problems for local consulates who would have to come to the assistance of uninsured travellers. The FCO has a “know before you go” campaign which encourages travel insurance;
- more consumers without cancellation cover between holiday bookings and travel dates; and
- if fewer policies are issued, the Government's Insurance Premium Tax (IPT) revenue will be reduced.

The travel industry is already heavily regulated with ABTA members in particular subject to our code of conduct which is rigorous and which has been amended to include provisions relating to the sale of travel insurance (see ABTA website [www.abta.com](http://www.abta.com)).

Suppliers of the insurance products used by travel agents are already FSA registered and the sales of these are monitored and regulated through their agents.

Increased regulation will have a disproportionate effect on smaller businesses who will find the fees and compliance cost of FSA regulation uneconomic.

Direct sales, especially those which are internet based, are regularly non-advised sales where the onus is on the consumer to ensure that the product is fit for their needs. Travel companies, however, are best placed to match policies to customer holiday needs because they know what kind of holiday and activity is being booked and what cover will be most appropriate.

Travel agents are able to assist consumers in the event of a claim, however, if they are no longer able to afford to offer insurance to their clients not only will this lead to more travellers taking a risk by ignoring insurance cover, the agents may find themselves in breach of the Package Travel Regulations.

*What steps has ABTA taken since 2003 to raise standards?*

ABTA runs its own compulsory educational qualification that members are required to complete and to date over 50,000 individuals have already taken the examination. Our training material has also been incorporated into a number of college courses leading to qualifications in tourism and leisure.

#### GENERAL OBSERVATIONS

The Government's Better Regulation Executive have said that they wish to see the burden of bureaucracy removed from business, particularly small business, any plans to include the travel industry within the scope of FSA regulation would add to that burden.

If there are to be changes to the way travel insurance is sold there would need to be a long lead-in time to incorporate those changes in, for example, brochures and contracts with suppliers and consumers.

We get very few complaints about the sale of insurance and while we are keen to see improvements in the service that our members provide, we think that our initiatives over the last two years demonstrate that self-regulation works. We believe that the Government should focus on the companies that operate outside of ABTA who remain unregulated by anyone.

*November 2006*

### **Memorandum submitted by the British Retail Consortium**

The British Retail Consortium (BRC) represents a wide range of retailers. On their behalf we would like to provide some very brief background information for the benefit of the Committee, which we hope will be of value in coming to any immediate recommendation on the sale of extended warranties, particularly on electrical goods.

In view of the very limited points we wish to make, we do not seek to make an oral submission.

1. For some years the BRC maintained a voluntary Best Practice Code covering the sale of extended warranties. However, the OFT and the Competition Commission did not regard this as a sufficiently robust contribution to establishing good practice, even though independent research conducted for the OFT suggested a high degree of consumer satisfaction with such warranties.

On that basis, after a lengthy and costly inquiry by first the OFT and then the Competition Commission, the Government decided to implement the Commission's recommendations.

2. This legislation now governs in considerable detail the manner in which the sales of such warranties must be made, including information that must be given to consumers before, during and after each transaction and the information that must be included in any advertisement.

3. In the view of the BRC, these regulations were excessively detailed and marked a departure from normal retail practice. They seemed to introduce more regulation for the warranty than for the product itself, which of course was far more expensive. Indeed the warranties themselves were often modest in cost compared with other financial products.

4. Nevertheless, we believe that these regulations have been fully observed. Certainly nobody has suggested to us that the opposite is the case. Given that the regulations were particularly designed to govern the sale of warranties in a retail outlet at the time of purchase of an electrical product, it would seem appropriate that they should be regarded as part of the overall sale of that product and enforced by the Trading Standards officers, acting with the OFT and DTI.

5. We note that the effectiveness of the regulations is due to be examined at the end of two years from their introduction—which falls early in 2007. We believe it would be inappropriate to recommend any changes to the regulations or the enforcement regime until that review has been completed.

We would therefore suggest that the Committee should refrain from making any specific recommendations for any changes prior to the review, though it may wish to suggest that the review itself should consider this along with other matters.

*November 2006*

---

### **Memorandum submitted by Daniel Tunkel**

#### INTRODUCTION

I am a partner with the Financial Services Group of SJ Berwin LLP. We advise clients on compliance with the UK financial services regulatory regime.

SJ Berwin is well-known in legal, commercial and Parliamentary circles; further information can be found at our web site: [www.sjberwin.com](http://www.sjberwin.com).

Since 2004, I have advised various clients as to their compliance with regulations implementing the Insurance Mediation Directive ("the Directive"). I will summarise examples of client activity below.

The views and analysis in this submission are mine exclusively, and should not be implicated to SJ Berwin LLP as such.

#### EXECUTIVE SUMMARY

It is my contention that the Directive has been incorrectly implemented. The effect of this is to make its regulatory sweep wider than was intended when implemented. Even given the Government's right to regulate beyond the scope of the Directive, I also contend that, in doing so, it has gone further than needed.

The contention above is derived from:

- (a) consideration of the text of the Directive itself, including—importantly—the recitals; and
- (b) a comparison of the Directive (in these respects) with the EC Investment Services Directive ("ISD").

There is a need for a proper regime for the regulation of those in the insurance brokerage industry who have a genuine interface with the public, and who are primarily responsible for either:

- (a) direct advice on insurance to purchase etc.; and/or
- (b) placement of insurance risk with underwriters.

But the manner in which this sector is now regulated catches tens of thousands of persons whose business:

- (a) does not include genuine public interface; and/or
- (b) amounts to a wholly neutral form of insurance arrangement-making.

The Directive was never intended to apply to such persons. Nor is there tangible benefit in such persons being subject to regulation. Rather, it unnecessarily increases the costs of their operations, to be ultimately passed on to consumers for no added benefit.

If the Directive has been incorrectly implemented, then it is incumbent upon the UK Government to adjust the rules which give effect to it. It is also open to affected persons to report this matter to the Commission in Brussels. I will not here analyse legislative changes that might be needed, but am happy to discuss these at a later date if appropriate.

#### SUBSTANCE OF THE ARGUMENT

##### *Initial policy of regulation of sale has been artificially widened*

The Treasury consulted on the regulation of insurance mediation on October 2002 (“the 2002 Consultation”), announcing that:

The Insurance Mediation Directive is intended to create a single market in insurance via a “passport” for EU retail insurance intermediaries. In return for the passport Member States are required to set certain minimum standards for taking up and continuation of the business of insurance mediation.

Chapters 1 and 2 of the 2002 Consultation focus on the need for a regulatory process connected to “sale” of insurance. See specifically paragraphs 1.3, 2.2, 2.15 and 2.16 of the 2002 Consultation.

Moreover (see paragraph 1.4) the Treasury acknowledges that the FSA’s powers to make relevant rules to address these areas is subject to the requirement to be risk-based and proportionate that applies to its rule-making powers generally.

Paragraph 3.1 the 2002 Consultation (citing Article 1 of the Directive) states:

The activities to be regulated are:

- introducing, proposing or carrying out other work preparatory to the conclusion of contracts of insurance;
- concluding contracts of insurance; and
- assisting in both the administration and performance of such contracts, in particular in the event of a claim.

The pivotal bullet is the second one, which, once again, turns on the physical selling process.

The Treasury expected to transpose these requirements into UK law by adjusting existing heads of regulated activity to accommodate insurance mediation alongside investment services. Para. 3.2 states:

The RAO will be amended to extend the current regulated activities of dealing in investments, arranging deals in investments . . . and advising on the merits of transactions in investments to cover all contracts of insurance. This will implement the Directive.

Here is where the problem lies. It is particularly the head of “arranging deals” (article 25(1) and (2) of the Regulated Activities Order), that creates much of the difficulty.

“Making arrangements for a person to deal . . .” (Article 25(2)) is subject to a wide general interpretation. Thus a Directive which, I submit, is intended to cover:

- (a) actual sales of insurance;
- (b) the doing of certain things which consummate such sales; and
- (c) if relevant, the process by which such sales are informed by giving advice or making available criteria for policy selection

has been widened to catch persons deemed to make almost any arrangements for another to become insured.

In paragraph 3.4, “making arrangements” was expressly stated by the Treasury to include the introduction of a person to an insurer *or an insurance intermediary* (my emphasis). The Directive does not call for anything so wide.

##### *No apparent exclusion for grouping*

The 11th Recital to the Directive reads:

This Directive should apply to persons whose activity consists in providing insurance mediation services to third parties for remuneration, which may be pecuniary or take some other form of agreed economic benefit tied to performance.

C.f. the opening of the 18th Recital to the ISD, which reads:

. . . the purpose of this Directive is to cover undertakings the normal business of which is to provide third parties with investment services on a professional basis; . . .

To me these are the same provision in slightly different words. I do not see a difference of principle between the ISD's "professional basis" and the Directive's "for remuneration".

The ISD, at Article 2(2)(b), expressly provides for group entities to avoid the need for regulation. I concede that the body of the Directive does not offer a similar express provision. But it was open, in my view, for UK legislation giving effect to the Directive to make such a provision, purely because recitals to EC Directives are always purposive, and both of these European measures conspicuously refer to the need for regulation of services to "third parties".

More to the point, however, the fact that Article 69 of the Regulated Activities Order was to be amended to prevent the usual grouping exclusion from applying passed entirely without comment in the 2002 Consultation. Since (as may be deduced from the example below) there has been a significant regulatory impact of this provision, I feel this was rather remiss.

Client A is my first example: a large quoted property group with significant insurance obligations. My provisional advice was that somewhere in Client A's group an entity had to seek regulation. We created a new subsidiary, provided for the obligations in question to be hived down to it, and in so doing, re-engineered the process by which Client A had hitherto arranged for insurance on properties owned within about 900 other group companies.

Then, under pressure from large corporate groupings, the FSA manufactured an analysis to the effect that the need for an insurance mediation activity to be "for remuneration" referred to payment of true profit-related value. Hence if the likes of Client A used a subsidiary for running renewals in consideration of its parent meeting its running costs alone, the Directive should not apply.

So I developed a basis, within Client A, for the new subsidiary to have duties for a cost-reimbursement basis only to procure insurances via Client A's broker relationships. In addition, several joint ventures which Client A had with other property owners (under the terms of which a Client A-owned entity carried out the insurance) had to be substantially redrafted to ensure that the relevant entity was not making any profit from doing so. This exercise:

- (a) cost Client A some several thousands of pounds in legal fees,
- (b) effected no changes in practice to the economics of its insurance commitments, and
- (c) proffered the general public no greater protection against misold or inappropriate insurance than it already has.

No entity within Client A was responsible for selling insurance or for creating advice upon which insurance should have been sold. All things considered, this was a waste of resource and time in avoiding compliance with a regime that should never have applied in the first place.

As a final remark in this section, Recital 9 to the Directive states that:

Various types of persons or institutions, such as agents, brokers or "bancassurance" operators, can distribute insurance products. . . .

On the *ejusdem generis* principle, I believe "agents" must refer to agents representing underwriters. The agent must have a relationship with a principal assuming the risk, dealing with the insured as a third party. No entity within Client A can be construed thus; any alternative conclusion is not consistent with a basic understanding of principles of agency law.

### *Plastic cards*

Another area of interest has been the interaction of the regulatory system with the manner in which insurance is—unavoidably—made available to the holder of:

- (a) a store credit card; or
- (b) a co-branded credit card linked to the MasterCard or VISA networks.

These days, embedded insurance may be:

- (a) linked to card usage (eg for goods purchased with the card); or
- (b) for use covering other risks (eg travel insurance).

That means that, nowadays, issuers become implicated in the insurance mediation regime. Here are two examples from personal experience.

Client B runs hotels. It offers a co-branded MasterCard.

- (a) The card is promoted via leaflets available from hotel reception and concierge desks.
- (b) Anybody interested completes an application and sends it not to Client B but to the bank (I will refer to it as "Bank X") which backs the card.
- (c) Bank X does not underwrite the embedded insurance, but operates as a (true) insurance mediator.

Client C is a store chain. It issues a store card.

- (a) The card is promoted via leaflets available at check-out and customer service desks.
- (b) A different bank (“Bank Y”) backs the card. In this case, application is made to Client C in name only, who forwards this to Bank Y.
- (c) Bank Y is also regulated to provide insurance mediation services, but not itself to underwrite the risk.

Both Clients are thus dragged into insurance mediation, because the Treasury considered that those who make arrangements for persons to be introduced even to other intermediaries need to be regulated. Consider that:

- (a) in neither case is advice given on the merits of the insurance (c.f. a store offering extended warranties—which is likely to be able to use the exclusion in Article 72B of the Regulated Activities Order);
- (b) the insurance cover is presented at no cost to the card holder;
- (c) were the cover insufficient (e.g. travel insurance not covering extreme sports), then he can take independent advice—albeit that the one entity he *cannot* approach for these purposes is the card issuer; and
- (d) any claim goes in effect to Bank X or Bank Y (not the card issuer), which are—correctly—regulated under the system to handle it.

I see no merit in either Client interfacing with the regulatory system. The fact that neither is directly regulated by the FSA (since both became appointed representatives of the Banks) is irrelevant. Even appointed representatives incur regulatory cost (in terms of compliance with the relevant Bank’s regulatory criteria, staff training etc.). And senior executives with each of these Clients, and thousands like them, must go on the record with the FSA. Why? What does this achieve?

#### *Non-public relationships*

Large property companies resource their own property management; smaller owners engage independent managing agents for this role. If that agent is not grouped with the property owner, as is the case with my Client D, then on the face of it, it must become regulated in order to organise the insurance arrangements for the property owner.

This is not a public-facing service. Client D does not hold itself out as offering to arrange insurance at large; it *only* does so where there is a written agreement with the property owner obliging it to do so. The risk to the property owner of Client D’s failure to insure is commercially the same as the risk that it fails to get the roof repaired or to evict a trespasser. This is—and should remain—“regulated” by the management agreement and the general law. I reiterate two observations from above:

- (a) Client D is the property-owner’s agent. In Recital 9 to the Directive the reference to “agent” is intended to apply to agents of the insurer; and
- (b) Client D is not involved in advising the property owner on insurance.

The regulation of maybe thousands of managing agents, who have closed-loop relationships with private landlords, is not in the public interest, occupies unnecessary regulatory time and generates an extra cost that must eventually be passed on to tenants via increased rents. These cost/benefit issues were not considered by the Treasury in the 2002 Consultation either.

#### *Provision of mere insurance information*

Client E came to me with a curious problem. It manages private equity funds. It had got together with three other such houses and they had formed a special purpose vehicle (“SPV”) which they owned in equal quarter shares. That SPV had compiled an intelligence database of providers that were likely to offer services to their investees. The list included providers of logistics, IT, office kit etc, and, of course, the names of two insurance brokers. The idea was that if any of those service providers were then consulted by investees, some sort of commission benefit (fully disclosed, of course) would flow back to the SPV and then be shared upstream by Client E and its three partners.

The definition of “insurance mediation” in Article 1 of the Directive notes that:

The provision of information on an incidental basis in the context of another professional activity provided that the purpose of that activity is not to assist the customer in concluding or performing an insurance contract . . . shall also not be considered as insurance mediation.

The Directive does not define “professional activity”. This provision has been transposed into UK law (see Article 72C of the Regulated Activities Order) by reference to “. . . a profession or business which does not otherwise consist of the carrying on of regulated activities.” (Again, unless I cannot see for looking, this semantic point was not addressed in the 2002 Consultation.)

In this rather peculiar set of facts, the SPV was, I considered, not carrying on regulated activities and hence within the Article 72C exclusion (even though owned by four investment firms which were not themselves so entitled). The FSA disagreed. Part of the basis for the FSA's view was its interpretative guidance at (what is now) PERG 5.6.7G, in which it (rather amusingly) observes that for a dentist to offer information on dental plans is incidental to dentistry but to offer information on pet plans is not.

But I am compelled to ask: what public benefit is there in the SPV being regulated at all?

- (a) Assuming that an investee of Client E's fund went to one of the specified brokers for a quote, that broker is regulated—by definition—to advise the investee on the nature of the risks and the sort of cover most suited to it etc. Why seek to regulate the SPV *as well*?
- (b) And while surely it was for such cases that Article 72C was intended (thus casting doubt upon the FSA's guidance in PERG 5.6.7G), would it not have been better to have used the language of the Directive in this respect to keep mere secondary information providers out of regulation (and regulate only those who provide information on the products and services they themselves sell or arrange)?

#### CONCLUDING REMARKS

I believe in this submission I have done two things. First, I have identified a basis for arguing that the Directive itself has been incorrectly transposed into UK law. Essentially this is because:

- (a) the Treasury forced the heads of activity in the Directive into the structure of the existing Regulated Activities Order, creating a situation where the making of arrangements was cast so wide that it included cases of colourless introduction of a potential insured to the sort of broker who *is* regulated to advise him properly;
- (b) no sensible attempt was made to ensure that provision of services to third parties should (as in the ISD and its implementation) exclude from regulation a lot of group arrangements; and
- (c) no account has been taken of the notion in Recital 9 that agents who deal in insurance there mentioned are agents of underwriters (rather than of insured parties).

Secondly, however, even if the current regime has been deliberately extended beyond the Directive, my contention is that this is conceptually excessive, and the outline examples provided above should amply demonstrate this.

I hope it might be possible, even now, for the submissions here to be a part of a deregulatory process. Tens of thousands of businesses are now caught by the UK's implementation of the Directive—vastly greater in number or sector than in other Member States (so far as I am aware). This imposes a significant extra cost on the system for no palpable benefit and no evidence of increased investor protection. And since most of the newly regulated entities are of a parochial character, the fact they are entitled to a passport to provide services into other Member States is irrelevant.

*November 2006*

---

#### Memorandum submitted by FSA Solutions

##### CONSULTATION TO EXPLORE SCOPE OF FSA GENERAL INSURANCE REGULATION

I have attached an article that I have drafted and submitted to a recent publication in the hope of it being published in the near future. The article is directly targeted at insurers as producers of these insurance products, and intended to alert firms to the proposed discussion and consultation documents which if implemented will extend their responsibilities and accountabilities significantly. The example that I used from my own experiences however illustrate the significant confusion that exists in the market.

I have however set out below other comments illustrations and explanations over why I believe we need to have more consistency of the in and out of scope general insurance activity.

##### *Extended Warranty*

Currently many retail outlets utilize existing exclusions in FSMA to continue offering extended warranty or other services related insurance without direct authorisation. Others have elected to become Appointed Representatives of FSA regulated firms to continue providing warranty and other insurance products.

In our practical experience the disclosure of the regulated status is poor or non-existent even after almost two years of FSA regulation. These distributors of the insurance are more often than not reputable branded names which instill consumer confidence, even if this confidence is often not matched by the skill, knowledge and competence of the sales staff.

This area of insurance has often led to inflated prices, excess or additional fees and undisclosed remuneration. These are practices that the FSA are seeking to address in their role as regulator but if current regulatory perimeters remain then my real concern is that the misselling scandals of pensions and endowments will simply be extended to general insurance.

Past experience demonstrates that such adverse reputational damage far exceeds the costs and lost revenue streams that can arise to the financial services industry itself, while the “brands” that actually are guilty of the misselling remain unpunished. Such a complex distortion to the level playing fields which promote health competition and innovation are unlikely to be in the long term interest of either the consumers or the financial markets themselves.

Similarly the inclusion in the FSA register will be undermined as firms will continue to be eligible to sell such excluded products and issue paper for one insurer while being tied effectively to another. Customers who the FSA seek to educate to look for key facts logos, and FSA authorisation will simply be confused.

#### *Other out of scope sectors*

In addressing EU competition, there has been great debate as to why the UK seek to include sectors that others have chosen to exclude such as freight forwards, builders, surveyors and the like.

As a consultants I have found that the various FSA decisions for inclusion and exclusion arguments to be somewhat inconsistent and further blurs the vision of “better regulation”. Customers needs simple and consistent messages regarding insurance products if healthy competition and innovation is to be encouraged.

Situations that I have recently experienced or am aware of with add on charges, incorrect or undisclosed additional premium charges being imposed and a generally poor appreciation for the insurance product that is being provided by these sectors should in our view cause as much concern as the extended warranty and travel debate.

While the FSA’s proposals to address the TCF concerns through the product producer are fine in theory, in our view these will more likely result in either the production being outsourced to unregulated firms either on-shore if the current scope of FSA remains unchanged or off shore if the scope is significantly increased.

Also some existing and valued insurance products will simply be too costly to provide when the costs of the regulation are factored in, or alternatively will be commercially unviable if the compensation culture that was generated in the past is sustained in the future. It is our opinion that in such matters regulation should not result in the curtailment of choice or indeed product range unless the products themselves promote consumer detriment.

#### *Our suggestions*

Clearly any suggestion of extending the scope of FSA regulation is unlikely to be well received by those that are currently outside the scope. However if consumer confusion is to be eased and a more equitable and level ground for competition is to be established then there must be some form of register to which all distributors and providers are required to subscribe.

Only then do we believe that customers can be told to check the status of firms on the FSA website to gain some assurance that they receive appropriate consumer protection. We do not however believe that the FSA should be asked to regulate all members on such a register.

Other regulated communities both inside and outside the UK could participate in such a scheme and in such a way some form of initial minimum entry standard over the business principles could be established.

Transparency over the relationship between distributor and a product provider ( who has in the end to hold capital in their appropriate jurisdiction) should also be required regardless of whether they are “FSA authorised” or not. In this way the consumer can chose between the products based upon brand and in full knowledge that a product provider such as the insurer can offer the contract through different distribution channels at differing prices.

The FSA register and authorisation stamp, then effectively represents an equivalent “British Standards” kitemark which is an already accepted and widely acknowledged differentiator. We also think that the FSA should be responsible for regulating that firms acknowledge and differentiate themselves between simple product distributors who sell versus others who advise. This differentiator does not exist in the current regulatory regime.

We would be pleased to assist you in any way that we can in your review of the FSA scope issues.

*November 2006*

## DRAFT ARTICLE

### *Mis-Selling Can Be Easy in the FSA's World*

The FSA have in the last few months published two documents for discussion or consultation which might significantly extend their influence and control over so called “perimeter business”.

DP06/04—sets out the FSA’s views for clarification and discussion, over the respective responsibilities of the product provider and that of the product distributor.

CP06/20—sets out the consultation on the new draft Conduct of Business Rules which reflect the amendments required to implement MiFid as well as the move to principles based regulation.

Both these consultations clearly outline an expectation that the standards of communication and selling in the regulated business will be extended beyond the perimeter for direct FSA supervision and control and into “out of scope” activities.

With many general insurance products actually being delivered direct to the end customer through distribution channels which may not require FSA authorisation, this early indication of the FSA’s expectations should be ignored at your peril.

With some distribution channels successfully utilising the exclusions that enable selling without any FSA authorisation or regulation, it is easy at the moment never to receive the basic information that the regulator requires from others. So the FSA have set out an expectation followed by a clear indication that the FSA regulated firm, as either product provider or distributor will have to ensure that they have addressed this mis-selling risk.

Using an example, we can show just how easy it is to find non-compliance and mis-selling risk, almost without even looking very hard.

While on holiday recently I indulged in some retail therapy and treated myself to a new kitchen and bathroom, complete with some appliances. Purchased from a well known major retail store, they included in my package price some extended warranty insurance over the white goods, with an inception date almost into 2008. No policy summary, no exclusions explained and no IDD involved at the point of sale.

The documents which followed to confirm the sale included a simple insurance certificate issued by the retail store in the name of a reputable insurance company. Had all the documents been in order, then my sale would have been complete.

### *But have I been mis-sold?*

Without knowing exactly the relationship between the insurer (the product provider), and the retail store (the distributor), as a knowledgeable buyer, I do wonder whether this insurance contract is actually legally enforceable.

From the FSA website, we can check the status of the retail store in question. It is an appointed representative, but unfortunately not of the insurer whose certificate of insurance was issued. This does make the store “authorised” as is the insurer so as a retail customer, but who is responsible for any mis-selling?

The communications made no disclosure of the regulated status of the distributor, although one document did confirm the normal retail price payable for the insurance cover provided.

No complaints or claims procedure was outlined nor were their any details of the compensation that might be available should either the insurer or distributor cease operations.

On the back of the insurance certificate, were some high level exclusions which included the use of the goods in any commercial use. I do work from home, so playing devil’s advocate, there is both domestic and commercial use of both the kitchen and bathroom albeit limited and perhaps incidental, so just exactly is covered and should I have been even given this insurance in the first place?

The FSA recently took enforcement action against firms selling unsuitable payment protection insurance, and has since issued warnings to consumers generally with regard to suitability standards applied by other distributors. The suitability issues highlighted are very similar to the exclusions which were not explained during this sale.

As a customer, at some point in the future might I justifiably question whether I had been “treated fairly”, and seek appropriate compensation if as with pensions and endowments such mis-selling generated the compensation claim culture.

*So what next?*

The next round of ARROW II assessments over products, distribution channels and the associated risk management of these areas should all seek to address the high level of mis-selling that currently can be found within product providers, when viewed against these FSA expectations.

While firms will have already assessed their own direct distribution chain, this will also need to be revisited in light of the uncertainty and changes made around the perimeter, which will require product providers know even more about their distributors.

While it will take time to address and rectify these issues, the TCF implementation plans should be complete by March 2007 so whether distributor or product provider there will be no excuse if firms have not at least assessed their risk in these areas and developed their action plans.

Selling your products through out of scope distribution channels will effect most product providers in some way and with the initial FSA expectations highlighted firms must quickly get to grips with the cost benefit reviews and arguments if they are to have any hope in demonstrating that customers gained through such channels have indeed been “treated fairly”.

---

### **Memorandum submitted by the Association of British Insurers**

#### INTRODUCTION

The Association of British Insurers (ABI) is the trade association for Britain’s insurance industry. Our 400 member companies provide over 94% of insurance business in the UK. We represent insurance companies to Government, regulatory and other institutions and are an influential voice on public policy and financial service issues. ABI member companies hold more than one-fifth of all the investments traded on the London Stock Exchange on behalf of savers and pensioners.

1. The UK insurance industry protects millions of households and businesses. This is possible because of the highly competitive UK insurance market, which gives high standards of customer service. Such a market is best supported by good-quality regulation which reflects consumer risks. This is generally the case. But the new sales regulations for general insurance—recently introduced as a result of EU legislation—do not yet take sufficient account of the important differences between products and market sectors. The FSA has recognised this, and is reviewing the current system. The ABI strongly supports this review, which aims to produce a more risk-based system with direct benefits for customers.

#### THE CURRENT EXTENT OF REGULATION OF THE INSURANCE MARKET

2. The FSA rules for selling general insurance and health protection products are known as the Insurance Conduct of Business or ICOB<sup>1</sup> rules. The rules do not apply to travel insurance where it is sold as part of a package, or extended warranties when sold with domestic electrical goods. The FSA review aims to tailor the current rules better to different market sectors. For example, the present regime imposes costs on customers purchasing core mass-market products (such as motor, household and travel) which clearly exceed the benefits<sup>2</sup>. The FSA’s recognition that a different regulatory regime may be appropriate for these sectors is very welcome.

#### *The need for, and potential effects of, extending regulation to the bundled travel insurance and extended warranty markets*

3. Extended warranties<sup>3</sup> when sold with domestic electrical goods are regulated by The Supply of Extended Warranties on Domestic Electrical Goods Order 2005, which implemented the results of a Competition Commission inquiry. The Competition Commission concluded that the remedies introduced were appropriate and proportionate to the consumer risks within that market. The Department for Trade and Industry has also issued supplementary guidance covering consumer information and cancellation and termination rights. The regulatory regime for extended warranties is implemented by local authority trading standards departments. The ABI believes that this part of the market is adequately covered, and that further regulation is not necessary.

---

<sup>1</sup> Life insurance products with an investment component, such as pensions and with-profits, are regulated by separate rules. These are more prescriptive than the sales rules that apply to similar products in most other EU markets and exceed those required by EU Directives. However, we welcome recent FSA proposals to simplify these rules, and we assume the focus of this inquiry is on general insurance.

<sup>2</sup> *Market Impacts of Regulation General Insurance*, CRA International 2006.

<sup>3</sup> The extended warranties market comprises both insured products and uninsured products. For the purpose of this paper, we are talking about insured extended warranties.

4. The situation is slightly different for travel insurance. While direct sales are regulated by the FSA, travel insurance sold as part of a package is currently unregulated (although some ABI members require travel agents selling travel insurance as a package to comply with FSA rules). The market for travel insurance is strongly competitive and the overall risk of consumer detriment low. The Foreign and Commonwealth Office is also rightly concerned that people should travel with adequate protection. It is therefore important that regulation does not put people off from purchasing travel insurance. The ABI's view is that appropriately tailored regimes should apply to all sales of travel insurance, whether direct or packaged.

5. The inclusion of thousands of travel agents within FSA regulation would represent a significant extra burden for the FSA. We believe local authority trading standards departments are better placed to regulate travel agents than the FSA.

*The form any proposed future regulation might take, including models for non-statutory regulation.*

6. The best model for regulation of travel insurance would be: (a) amending the regime which already applies to direct sales to ensure that customer benefits outweigh costs; and (b) ensuring that a similar level of protection is afforded to customers where travel insurance is sold as part of a package. For the reasons given above, extending FSA regulation does not seem attractive but a regime similar in administration to that applying to extended warranties on electrical goods (see paragraph 3 above) could achieve the right balance. Such a regime should take account of, and reflect, the conclusions of the FSA review. This light touch regulation could be supplemented by:

- an industry Code of Practice similar to those which existed before the introduction of statutory regulation (the General Insurance Standards Council rules for intermediaries, and the ABI Travel Insurance Selling Code);
- industry training standards to ensure good selling practices;
- an extension of the remit of the Financial Ombudsman Service to cover packaged travel insurance sales, allowing customer disputes over sales to be addressed independently, as for direct sales.

November 2006

---

### **Memorandum submitted by Campaign for Effective Training and Competence**

#### OUR FOCUS

Our primary focus as a campaign group is to promote the highest standards of training and competence within the financial services industry. We recognise that the current approach to delivering training and competence plays an important role in delivering a highly skilled and competent workforce which is better able to protect the interests of consumers thereby promoting the reputation of the industry over the long-term. In this way training and competence rules can also play an important role in ensuring that wider regulatory requirements, such as the high-level principle of treating customers fairly, can be more effectively embedded by firms.

#### INDUSTRY TRAINING: DISTINCTION BETWEEN COB AND ICOB BUSINESS

Under FSA rules firms selling investment-linked products through the Conduct of Business (COB) Handbook are required to provide ongoing training within a regime of appropriate examinations. Such requirements are not currently applied to those salespeople carrying out general insurance activities including selling protection-only products through the Insurance Conduct of Business (ICOB) Handbook. It is the ICOB rules which sought to implement the Insurance Mediation Directive (2002/92/EC). That Directive did not apply to travel insurance sold by travel agents or extended warranty products. Thus there are certain types of insurance transactions not caught by UK regulation. Added to this there is varying regulation for travel insurance dependent upon the buying process. The situation is both confusing and potentially detrimental to the consumer. We therefore welcome the current enquiry into the scope of regulation.

#### OUR SUBMISSION

We welcome the opportunity to make this submission in order to highlight how some of the problems currently facing the general insurance market could be partially offset by more stringent systems of training and competence.

## EXECUTIVE SUMMARY—IMPACT OF THE UK’S IMPLEMENTATION OF IMD

- *An unlevel playing field*; the UK’s implementation of Directive 2002/92/EC presents us with an unlevel playing field, which forms a serious challenge in industry’s attempts to provide effective consumer protection.
- *Additional consumer risk*; the lack of regulatory oversight of certain market sectors creates additional consumer risk, which consumers themselves are often unaware of at the point of sale.
- *Improved training and competence (T&C)*; we note that the UK already has T&C rules in place under the guiding principle of enhancing consumer protection by ensuring that firms put in place appropriate training and assessment of employees to help them better assess the needs of consumers. How this principle is applied to the general insurance market should be of primary concern to this inquiry.
- *Policymaker response*; within the current climate of the *Better Regulation agenda* we welcome the Government’s recognition that statutory rules are not always the most appropriate response to a market problem. We would therefore like to see a detailed assessment of what firms currently do to promote the capability of employees to understand the needs of their customers when selling any pure-protection insurance product, whether the general insurance policy sold currently falls within the scope of ICOB or not.

## IMPLEMENTATION OF IMD: OUR POSITION

1.1 We welcome the Committee’s decision to focus on the current extent of regulation in the insurance market following the implementation of Directive 2002/92/EC (“the Directive”). The Directive adopted a minimum harmonising approach which gave Member States the freedom to determine the scope of national transposition in certain key areas. For example, in those cases where intermediaries are offering insurance contacts on an ancillary basis as a secondary purchase linked to a holiday.

1.2 How the various Member States exercise these freedoms is of course critical to both the effectiveness of the Single Market, as well as the extent to which the new regulations offer effective consumer protection. While the impact on the creation of a Single Market is worthy of detailed investigation, our primary concern here is the effect on consumer protection.

*An unlevel playing field*

1.3 Under the provisions contained in Article 1.2 of the Directive the UK’s transposition allowed for certain individuals to operate outside the scope of the FSA. The decision to pursue this approach has created an unlevel playing field between different distribution channels which in turn creates the danger of “distribution bias” in which some routes to market receive a more favourable regulatory treatment, presumably on the basis that they form a lesser risk to consumers. However, the regulations as they are currently framed actually favour those forms of distribution which offer least consumer protection, and in which the salespeople have typically received the least training to help them understand the terms and conditions of the policies which they sell.

*Assessing consumer risk*

1.4 The lack of regulatory supervision over certain elements of the general insurance market has introduced additional elements of consumer risk. While typically the policies being sold—whether it be travel insurance or warranty products—are not highly sophisticated or complex, there is still a need to ensure that the policy terms and conditions are appropriate for the consumer’s needs.

1.5 While much has been made of the need to improve the financial capability of consumers in order to help them gauge whether or not a product is appropriate, there is clearly a need to address residual issues over the capability of those people selling the products to ensure that they properly understand the key features of the cover they are providing. When the FSA talks of “information asymmetry” it assumes the people selling the product always know more about the transaction than the consumer. Clearly, in some transactions this might not be the case, as the FOS annual reports over several years indicate. Therefore, one of the key risks facing the consumer is the lack of statutory training and competence amongst unregulated salespeople.

1.6 Evidence to date suggests that where intermediaries have been excluded from regulatory oversight there has been a detrimental effect on the consumer experience.

2. CONSUMER OUTCOMES—CASES FILED WITH THE FINANCIAL OMBUDSMAN

2.1 It is clear looking at complaints filed with the Financial Ombudsman’s Service (FOS) that travel insurance has consistently proved to be a problematic area in terms of current outcomes for consumers. Figures from recent annual reports reveal the growth in complaints relating to travel insurance (see Table 1).

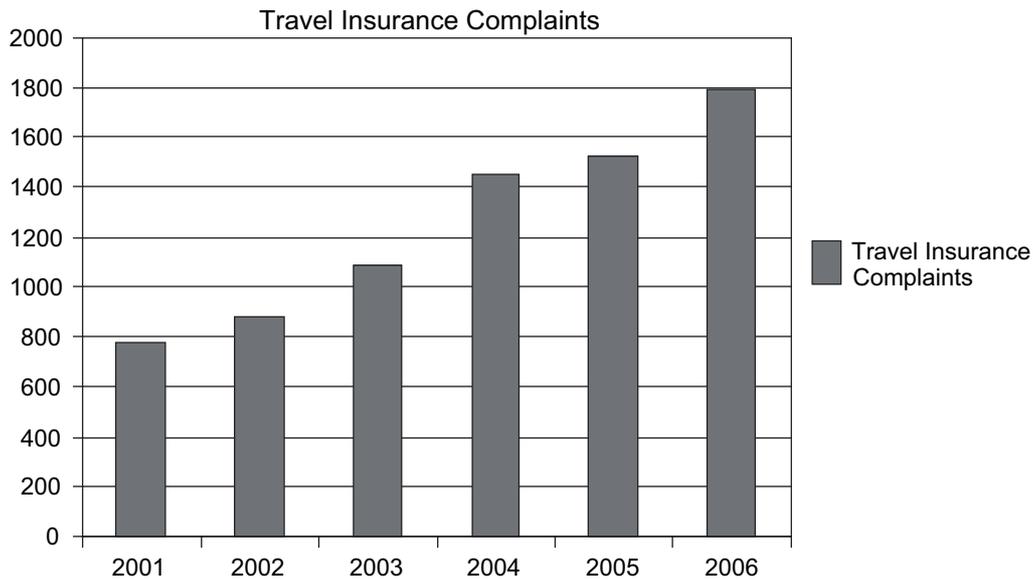
2.2 In its 2006 annual report the FOS comments that;

2.2.1 *“Disputes arising out of travel insurance claims have increased by 17% over the year—and are now more than double the number we received in 2001–02”*

2.3 While the FOS had commented previously in its 2005 annual report that;<sup>1</sup>

2.3.1 *“A number of the disputes that are referred to us relate to the exclusion that insurers apply to claims involving “pre-existing medical conditions” . . . where a customer subsequently makes a claim on a policy, it may also have led to some staff at travel insurers becoming confused between the insurer’s right to “avoid” (retrospectively cancel) a policy as a result of the customer’s non-disclosure or misrepresentation and the insurer’s right to rely on the exclusion relating to pre-existing medical conditions”*

2.4 Table 1: Complaints to FOS driven by travel insurance sales (2001–05)



3. POLICY SOLUTIONS:

*Assessing the benefits of training standards under COB*

3.1 By highlighting cases where employees have failed to grasp the key features of the policies they are selling, the FOS provides an important insight into the current levels of competence within this market sector.

3.2 This can be contrasted with the COB regime, in which the FSA insists upon a system of mandatory exam requirement under Chapter 2 of the Training and Competence Rulebook (TC2) for those working in retail and wholesale markets.<sup>2</sup> This requirement is justified by the FSA, and supported widely throughout the industry, as a means of enhancing consumer protection by ensuring that firms put in place appropriate training and assessment of employees to help them better assess the needs of consumers.

3.3 The existence of explicit training and competence requirements in the fields of investment and mortgage advice has ensured that the issues around competence highlighted by FOS are addressed by firms which are made aware of their responsibilities. The requirements have established a consistency to a benchmark standard of competence amongst advisers. Furthermore, these requirements are clearly valued by advisers as a pre-requirement to progress in their careers which helps to build their confidence, knowledge and understanding.

3.4 The requirements have also created a currency in the recruitment and assessment for both firms and advisers. The ability of advisers and firms to demonstrate that individuals have been assessed independently and are subject to ongoing supervision and verification of continuing competence is a valuable means of building consumer confidence. In the past remedial training has proved a useful tool for regulators especially

<sup>1</sup> Though the FSA intends to disapply the exam requirement in the wholesale sector from November 2007.

<sup>2</sup> FSA Consultations are so complex that no firm can deal with them without employing a full time member of staff to understand the language and try to see what the FSA intend—which is rarely obvious.

where initial training has been ineffective. Some high profile cases in the pre-FSA regulatory regime reinforced firms' awareness of their responsibilities and it is notable that there have been no significant reports of failings in the delivery of training or assessment of advisers over the past few years. Whilst it is impossible to establish a causal link with any certainty the training and competence requirements of FSA are likely to have reduced the number of instances of advisers providing inappropriate advice.

#### *Training Standards Under ICOB*

3.5 How this principle, of enhancing consumer protection through industry training, is applied to the general insurance market is a key issue given the comments of the FOS. It is clear that more needs to be done to improve training and competence within the non-regulated travel insurance market, as well as within the regulated ICOB regime, in order to ensure that firms are better placed to sell their products, particularly in a market which is noted by the FOS for "widespread misunderstanding" amongst consumers.

3.6 The relatively low instances of consumer detriment through inappropriate advice on general insurance matters where such products are sold through "specialist" providers or distributors may well be linked to the voluntary implementation of sound training and assessment practices in much of this sector. Many firms encourage if not require qualification even though this is not a specified requirement in regulation. The extent to which some firms and many individuals have taken up existing independent examination provision offered by bodies such as the *ifs School of Finance* and the *Chartered Insurance Institute* suggests a willingness to apply best practice.

3.7 However, with the lack of any regulatory supervision it is difficult to reinforce the need for appropriate training and competence measures. Little is known about the extent to which firms currently apply training on a voluntary basis, or whether the lack of training is playing a major role in explaining possible consumer detriment where it does occur.

3.8 At the very least we would like to see at this stage a detailed assessment of what firms currently do to develop the capability of employees to understand the needs of their customers when selling any pure-protection insurance product, whether the sale currently falls within the scope of ICOB or not. This should not imply that firms selling policies under ICOB rules would eventually be subjected to similar requirements to those people selling policies under COB rules. However, there is a general need for greater emphasis on training in improving outcomes for consumers.

3.9 The above comments have largely focused upon the risks associated with Travel Insurance where the potential detriment can be huge eg inadequate medical cover in the US. Extended Warranties associated with consumer goods are less risky in financial terms. However, there is considerable merit in consistency of treatment of all general insurance contracts and the need for consumer certainty outlined above applies equally to this type of arrangement.

*November 2006*

---

### **Memorandum submitted by Norwich Union**

#### ABOUT NORWICH UNION

1. Norwich Union is the UK's largest general insurer with a market share of around 14%. With a focus on insurance for individuals and small businesses, Norwich Union insures one in five households; one in seven motor vehicles and around 800,000 businesses.

2. Norwich Union products are available through a variety of distribution channels including brokers, corporate partners such as banks and building societies and via the Internet through Norwich Union Direct.

3. Norwich Union has been a key contributor to debate on the general insurance regulatory regime in the UK and has participated, both directly and indirectly via the ABI, in a range of Government and FSA consultations and events.

#### EXECUTIVE SUMMARY

4. Norwich Union supports statutory regulation. We believe having consistent authorisation and enforcement, coupled with minimum standards in key areas, is beneficial to consumers and firms alike.

5. Regulation must be fit for purpose and the role of the regulator is to ensure there is sufficient protection for consumers whilst at the same time taking care not to stifle competition and innovation.

6. To date, the track record of the general insurance industry has been good; therefore, Norwich Union believes that the regulatory regime in its current form is disproportionate to the overall risk the market represents.

7. Whilst there are some valuable consumer benefits with the current regime, the detailed rule book has led to increased documentation, fuelling customer apathy, and inappropriate rules for direct insurers.

8. At the outset of the regime two key areas were omitted from regulation—Travel insurance sold as part of a package and extended warranties on domestic appliances. Norwich Union strongly believes that the sale of these contracts should be regulated by the FSA to strengthen consumer protection and consistency across the insurance industry.

9. Norwich Union is an advocate of risk based regulation and believe that the “low risk” nature of products such as motor, home and travel insurance should be reflected in the level of regulation applied. We support the FSA’s view that the mix of detailed rules and high level principles needs rebalancing.

10. The Government’s 10 point plan for modernising regulation, and the FSA’s Better Regulation agenda, are both parts of the growing desire to alleviate the regulatory burden on business in the UK. Norwich Union believes that both the Government and the Regulator are genuine in this aim, and we welcome their intentions.

*The current extent of regulation of the insurance market*

11. In reviewing the current regime it is important to recognise the positive aspects it has delivered, in particular, consumers and businesses are benefiting from improved protection. This can be seen through access to the Financial Ombudsman Service and a wider spread of protection under the Financial Services Compensation Scheme.

12. As well as these more visible benefits, there is a consistency of authorisation and enforcement across the industry, underpinned by a set of minimum standards for all providers to apply, around financial protection, common complaints processes and governance of distribution.

13. However, the implementation of the underlying EU legislation has been excessive and littered with “gold plating”. The largest example of which was the inclusion of direct insurers in rules emanating from the Insurance Mediation Directive, which was intended for the intermediary market.

14. Overall, there was a “broad brush” rather than risk based, approach to the implementation of the Insurance Conduct of Business. This has led to all products within the regime attracting the same level of detailed rules, which has not necessarily been beneficial for the consumer.

15. Particular issues that have arisen since the introduction of the general insurance regime are:

- (a) **Documentation**—the amount of documentation that customers receive has increased greatly. In addition to the policy schedule and booklet, customers are now inundated with documents such as status disclosure, policy summaries and “demands and needs” statements. To demonstrate the impact on the consumer, this has led to 12 extra pages of additional literature for our new household customers.  
This additional documentation can in fact be detrimental to the customers understanding of the product as too much information leads to customer apathy where the customer potentially reads less.  
Norwich Union believe that this area needs addressing in order to simplify the point of sale documentation to make it easier for customers to understand and to reduce unnecessary paperwork.
- (b) **Direct insurers and intermediaries**—Whilst Norwich Union welcomes the steps the FSA has taken this year to differentiate between direct insurers and intermediaries, we believe this should be taken further. As mentioned earlier, the Insurance Mediation Directive was intended for the intermediary market. By extending the scope of the directive, direct insurers have been required to implement rules that are inappropriate to their business models. The services offered by these distribution channels are different and the regime should reflect this—insurers only offer their own products and do not recommend between providers.
- (c) **Advised/non advised**—This is an area of the current regulatory regime that leads to confusion for consumers. Regardless of a firm’s sales approach, most customers purchasing a contract of insurance believe they have received some form of advice. Norwich Union believes that the current advised/non-advised label should be replaced with an overarching principle setting out what the FSA expects by way of customer outcomes in relation to the point of sale. This will be strengthened by the existing Treating Customers Fairly principle and firms will be required to demonstrate how the consumer’s best interests have been satisfied in each transaction.

*The need for, and potential effects of, extending regulation to the bundled travel insurance and extended warranty markets.*

16. Norwich Union advocates that both travel insurance, sold as part of a package, and extended warranties should be subject to the same regulatory regime as all other insurance contracts. This will provide the consistency of authorisation and enforcement that exists throughout the rest of the industry.

17. Both are contracts which are at risk of being mis-sold by non-insurance salesmen, whose sales practices are not regulated by the FSA, leaving consumers unprotected at the point of sale.

18. In addition to the risk of direct detriment to consumers, there is also a danger that the current sales practices of these products will damage consumer confidence in the wider insurance industry.

19. Whilst recognising that there is a gap in the regulatory framework with regard the sale of these contracts, Norwich Union believes that the products themselves are “low risk” and would recommend that the extension of the regime to include these contracts is proportionate to their risks.

#### *The form of proposed future regulation*

20. Norwich Union would like to take this opportunity to commend both the Government and the FSA on the Better Regulation agenda both are committed to follow. In particular we support the review of the regulatory regime the FSA is completing and are encouraged by their initial suggestions.<sup>1</sup>

21. Norwich Union has long advocated a risk based regime where regulation is proportionate to the inherent risk posed to the market. The risks to general insurance consumers are of a lesser nature than those faced by consumers of life, investment or banking products. General insurance contracts are pre-dominantly on an annual basis and are of a simple nature, with low exit barriers. We believe that these facts should be reflected in the level of regulation applied to products such as motor, home and pet insurance, to name a few.

22. In order to achieve a more risk based regime, Norwich Union agrees with the Chairman of the FSA Sir Callum McCarthy’s recent comment that the mix of principles and detailed rules needs to be rebalanced. We believe that the current detailed rulebook should be replaced with a set of high level principles, based on the current “Principles for Businesses”, backed by relevant regulator or industry led guidance.

23. In addition, where issues are identified within the market, industry led solutions should always be the regulator’s first avenue. We agree with John Tiner’s, Chief Executive FSA, sentiment that “*the regulators’ mantra should be to intervene only where there is a bona fide market failure and where economic argument makes the case for intervention*”<sup>2</sup>. Contract certainty is a good example of the industry putting its own house in order following a challenge by the FSA.

24. Such a regime will be more suitable to maintaining consumer protection whilst at the same time allowing firms to be more innovative in the way they meet their customers’ needs.

25. There will be many challenges in achieving such a regime, not only to regulated firms but also for the FSA’s supervision and enforcement teams and the decision makers at the Financial Ombudsman Service.

November 2006

---

#### **Memorandum submitted by Comet**

Comet welcomes the opportunity to comment on the Treasury Select Committee’s decision to investigate whether extended warranties should be subject to regulation by the FSA.

Comet is not in the market for travel insurance, so its response will be confined to extended warranties for electrical products (EWs).

Extended Warranties for electrical products have been the subject of a number of investigations. As a result, the way extended warranties are permitted to be sold is already very tightly governed. Comet suggests that any further regulation by the FSA is therefore unnecessary.

Comet’s Vision is to be “Britain’s most trusted electrical specialist”. Comet believes that by earning customers’ trust, it can make the shopping experience more rewarding for the customer thereby encouraging future loyalty. However it does recognise that this trust must be earned and so has embarked on an extensive and ongoing retraining programme of all colleagues within the business to support this Vision. Additionally, store colleagues are no longer incentivised on the sale of individual products and services.

Through their experience with Comet, we want customers to say:

*“Shopping is easy at Comet.*

*I am treated with respect by knowledgeable, enthusiastic and friendly staff who care about me.*

*I trust them to always help me make the right decision and to support me through the life of my product.”*

This Vision ensures that the business is focussed on providing high levels of service and specialist knowledge so that customers can make their purchase decision with full confidence.

---

<sup>1</sup> FT Bankers awards. 6 September 2005.

<sup>2</sup> FSA Consultations are so complex that no firm can deal with them without employing a full time member of staff to understand the language and try to see what the FSA intend—which is rarely obvious.

As the Treasury Select Committee are no doubt aware, extended warranties were the subject of a recent Competition Commission Inquiry. This inquiry noted that:

*“We did not find evidence that EW providers were deliberately acting in a way that encouraged pressure on consumers; in fact we accept that they discourage it.”<sup>1</sup>*

It concluded that where there were examples of poor selling practices, this was being addressed in line with the BRC Code and that the Code was a useful expression of best practice.<sup>2</sup> Comet fully supports this code of best practice which is consistent with its Vision.

The Inquiry identified other deficiencies in the market for extended warranties for which remedies have been introduced, such as:

- Providing customers with more information so that they could make more well-informed choices;
- Ensuring that EW prices were displayed alongside the product price both at the point of sale and in advertisements;
- Better cancellation rights for extended warranties (better in fact than on any other financial services product); and
- The right to terminate an EW and get a *pro-rata* refund at any time.

These requirements had to be in place early in 2004 with a suggestion from the Secretary of State for Trade and Industry that the OFT review the position two years after implementation.

Comet therefore believes that the market for extended warranties is subject to several provisions to protect customer interests. Furthermore, there is a continuing process for understanding whether customer interests are being protected and that therefore additional investigation and regulation is both unnecessary and excessive.

November 2006

---

### Memorandum submitted by Direct Line

#### EXECUTIVE SUMMARY

- Direct Line has campaigned for a level playing field in the travel insurance market since 1999—where insurers and travel agents should be subject to the same commitments and regulations to ensure a high standard of customer service.
- Through non-regulation of travel agents activities in selling insurance, consumers are exposed to unnecessary and avoidable risks when they go on holiday. Many consumers are unaware of these risks and I assume that travel agents are regulated in the same manner as insurers when selling travel insurance
- Mis-selling of travel insurance by travel agents remains a significant problem, especially in relation to pre existing medical conditions.
- By presenting the consumer with obstacles that make it more difficult to purchase travel insurance separately from their holiday, travel agents are inhibiting the ability of consumers to make a choice that is suitable for their own set of circumstances.
- Direct Line believes that an appropriate light touch regulation regime should apply to all sales of travel insurance, whether direct or packaged—ie a level playing field.

#### Overview

1. Direct Line welcomes the Treasury Select Committee’s inquiry into the scope of FSA regulation of the insurance industry, and in particular, the need for and the potential effects of extending regulation to the bundled travel insurance market.

2. Direct Line has been campaigning since 1999 for a level playing field in the travel insurance market—where insurers and travel agents should be subject to the same commitments and regulations to ensure a high standard of customer service. It is on this aspect of the current Select Committee Inquiry, that Direct Line will be submitting a response.

3. In 2002, Direct Line produced “*The Tourist Trap Report*”, which outlined how travel agents selling travel insurance as part of a bundle package stood to gain, and the anti consumer practises that they engaged in. In 2003, GISC was the non-statutory regulator, indeed, statutory Government regulation of insurance

---

<sup>1</sup> Competition Commission : *Extended warranties on domestic electrical goods*, Volume 1, Summary and Conclusions 2.363.

<sup>2</sup> Competition Commission : *Extended warranties on domestic electrical goods*, Volume 1, Summary and Conclusions 2.114.

only came in under the auspices of the FSA from 14 January 2004. The Government chose not to regulate sale of travel insurance by travel agents at that time and the arguments that Direct Line's report set out to ensure consumers are adequately protected, are as applicable in 2006 as they were then.

4. Direct Line has already submitted "*The Tourist Trap Report*", associated press releases on this issue, and more recent consumer research from October 2006, upon request from the Treasury Select Committee.

#### EXTENDING REGULATION TO THE BUNDLED TRAVEL INSURANCE MARKET

##### *Inquiry Question 2: The need for, and potential effects of, extending regulation to the bundled travel insurance*

5. Although many travel agents sell insurance, they are not regulated, and consequently do not have a standard of conduct to achieve in their dealings with consumers. Through non-regulation of travel agents activities in selling insurance, consumers are exposed to unnecessary and avoidable risks when they go on holiday. Many consumers are unaware of these risks and if their insurance fails, they are left with significant costs that they have to foot themselves.

6. Direct Line would urge the Treasury Select Committee to recommend that the Government introduces regulation that will cover the sale of travel insurance by travel agents. From a consumers' point of view, it is expected that the process and the conditions under which consumers buy travel insurance are exactly the same, regardless of where it was bought. A recent study conducted by YouGov on behalf of Direct Line showed that 83% of British holiday makers were unaware that travel agents sell travel insurance without being subject to the same regulation that insurers are subject to. The survey also found that there is strong support for this situation to be rectified, with 91% of British holidaymakers in favour of introducing regulation.

7. There are a number of anti consumer practises undertaken by travel agents and tour operators that the Government needs to address in order to ensure that consumers are aware of what they are paying for, and what they are not. The two most notable practises are:

##### *Mis-selling of Travel Insurance*

8. The Financial Ombudsmen Service report in 2001 argues that the biggest problem with travel insurance is that is normally sold as an add-on to another product—typically the holiday itself. Because travel agents often sell insurance as a "free product" or part of the holiday package, many consumers do not receive adequate guidance at the point of sale as to which product best suits their individual needs. This remains a valid statement today.

9. A recent study conducted by YouGov on behalf of Direct Line has found that 64% of holiday makers sold insurance by their travel agents will not have had their policy explained to them clearly, and as a result more than 13% will be leaving the UK not knowing what they are covered for.

10. Many disputes over claims arise through a failure to properly inform consumers of the policy features or explain how the various exclusions and limits are applied. In this regard, medical conditions are a particular cause for concern, with 55% of holidaymakers not asked about pre-existing medical conditions by travel agents. Remarkably, this figure has actually gone up by 2% since 2002 when Direct Line undertook a survey through MORI as part of its research for "*The Tourist Trap Report*".

11. Additionally, of the respondents to our most recent survey, 72% were not asked about cancer or heart related conditions, 77% about whether they have high blood pressure, and 75% about whether they are awaiting any form of medical investigation or surgery.

12. 20% of all holidaymakers travel with a pre-existing medical condition. Not being asked about these conditions may mean that holidaymakers are not appropriately covered and are risking damage to their health or considerable financial loss if they require treatment whilst abroad or repatriation to the UK.

13. Direct Line feels that the argument for Government to subject travel agents selling travel insurance to the same regulation that insurers currently work, is compelling on the basis of this argument alone.

##### *Barriers to Consumer Choice*

14. By presenting the consumer with obstacles that make it more difficult to purchase travel insurance separately from their holiday, travel agents and tour operators are inhibiting the ability of consumers to make a choice that is suitable for their own set of circumstances.

15. Direct Line's recent survey found evidence of "hard sell" techniques, with 4% of holidaymakers who buy insurance from a travel agent admitting they were pressured by the agent into taking it out. 14% of holiday makers who were sold insurance by a travel agent were not being given time to consider their options by the agent and 7% were subjected to confusing jargon. Perhaps most concerning, is that one in 20 holiday makers were told that they would not be able to travel without taking out insurance with the travel agent that sold them the holiday.

RECOMMENDATIONS

16. Direct Line believes that an appropriate light touch regulation regime should apply to all sales of travel insurance, whether direct or packaged—ie a level playing field.

*November 2006*

---

**Memorandum submitted by British Insurance Brokers' Association (BIBA)**

1. INTRODUCTION

1.1 The British Insurance Brokers' Association (BIBA) welcomes the Committee's inquiry into the scope of FSA insurance regulation following the implementation of the Insurance Mediation Directive.

1.2 BIBA represents the interests of 2,100 insurance brokers and intermediary businesses, ranging from Lloyds brokers and the major international brokers to small regional firms.

1.3 In total, our members handle over £26 billion of premiums and are responsible for generating the vast majority of insurance brokers' invisible earnings, amounting to almost £2.1 billion in 2004.

1.4 BIBA handles some 50% of the general insurance premiums placed in the UK market and more than 75% of business transacted by insurance intermediaries.

1.5 The timescale for response to this inquiry has not permitted BIBA to consult with its members and it would welcome the opportunity of responding further on aspects of these questions, after proper consideration, at a later date.

2. CURRENT EXTENT OF REGULATION OF THE INSURANCE MARKET

2.1 The implementation of the IMD in the United Kingdom was completed on 14 January, 2005. The implementing legislation was the Insurance Mediation Directive (Miscellaneous Amendments) Regulations 2003 (SI No 1473/2003) (amendment) (no2) Order 2003 (SI No 1476/2003) and the Financial Services and Markets Act 2000 (Exception) (Amendment) (no2) Order 2003 (SI 1675/2003). All insurance intermediaries are now regulated by the Financial Services Authority (FSA).

2.2 The Financial Services Authority (FSA) is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000.

2.3 All of the Rules and register of authorised firms are available on the FSA website [www.fsa.gov.uk](http://www.fsa.gov.uk).

3. THE NEED FOR, AND POTENTIAL EFFECTS OF, EXTENDING REGULATION TO THE BUNDLED TRAVEL INSURANCE AND EXTENDED WARRANTY MARKETS

3.1 BIBA strongly believes that it is in the best interests of customers for the sale of all travel insurance, whether bundled or otherwise, to be subject to the same regulatory requirements. This must include point of sale disclosures together with access to both independent complaints redress (via the Financial Ombudsman Service) and compensation in the event of intermediary failure (via the Financial Services Compensation Scheme).

3.2 Travel insurance is a complex product and it is essential that the customer properly understands what is being purchased—for example the implications of pre-existing medical conditions being disclosed.

3.3 BIBA believes that applying common standards of regulation to all those involved in selling general insurance is a positive step, creating a level playing field and raising standards, which will help avoid any possibility of mis-selling. BIBA has opposed the proposal to take freight forwarders out of regulation.

3.4 BIBA hopes to make a formal response to HM Treasury at a later date including the result of independent consumer research.

4. THE FORM ANY PROPOSED FUTURE REGULATION MIGHT TAKE, INCLUDING MODELS FOR NON-STATUTORY REGULATION

4.1 While there has been insufficient time to submit detailed proposals on what form future regulation might take, BIBA would like to make the general point that we support the principle of proportionate and cost-effective regulation.

4.2 Prior to the implementation of the IMD on 14 January, 2005 intermediaries were not subjected to statutory regulation. The FSA has brought intermediaries into line with all its other regulated bodies, which impose equivalent, or in instances, more onerous regulation than that laid down in the IMD. The UK is unique among EU Member States in having a single regulatory body responsible for the whole of the

financial service section, including insurance mediation. The consequence has been a hugely complex regulatory framework, incorporating more than 14 sourcebooks, which has proved to be difficult and costly to implement.

4.3 BIBA supports the move towards a more principle based regulation but even then would hope to see a more streamlined approach. There are for example 350 pages, including the attachment, to the Reforming Conduct of Business Regulation for MIFID firms.

4.4 BIBA would wish to ensure that any future regulation ameliorated in part the significant competitive disadvantage which the UK now has in comparison with its European counterparts. It would also be concerned to ensure that any growth in regulation did not result in a serious barrier to new and small businesses, where the regulatory costs can fall most heavily.

4.5 Principle based regulation would be supported subject to clear and definitive guidelines on what regulators expected from intermediaries and assurance that proper diligence was taken of the size of business involved.

4.6 Care needs to be taken to protect competition between UK and overseas intermediaries. Variations in Member States legislation, particularly in relation to compulsory insurance combined with a lack of clarity of local rules act as a deterrent to competing on a cross border basis. To this end flexibility in interpreting statute based regulation, which has been created to apply to a number of diverse regulated entities, is vital.

## 5. SUMMARY

5.1 BIBA supports the principle of proportionate and cost-effective regulation. We would wish to ensure that any future regulation ameliorates the significant competitive disadvantage that the UK suffers in comparison with other parts of Europe. We are also concerned to ensure that growth in regulation does not result in a serious barrier to new and small businesses.

5.2 On travel insurance, BIBA believes that it is in the best interests of consumers that all travel insurance, whether bundled or otherwise, should be subject to the same regulatory requirements.

*November 2006*

---

### **Memorandum submitted by the Financial Services Authority**

#### A. INTRODUCTION

1. This memorandum is submitted by the Financial Services Authority (FSA) in the context of the Committee's Inquiry into the scope of the FSA's insurance regulation following the implementation of the Insurance Mediation Directive (IMD).

2. The memorandum covers:

- the FSA's overall approach to regulation;
- the Treasury's role in setting our regulatory scope and deciding on any extensions;
- the implementation of the IMD and the FSA's regulatory responsibilities in relation to general insurance; and
- our plans for reviewing the conduct of business rules applying to the sale and administration of general insurance.

#### B. THE FSA'S OVERALL APPROACH TO REGULATION

3. The Financial Services and Markets Act 2000 (FSMA) gives us four statutory objectives:

- to maintain market confidence;
- to provide the appropriate degree of consumer protection;
- to promote public understanding of the financial system;
- and to reduce financial crime.

In carrying out our general responsibilities we must also have regard to seven principles of good regulation, including using our resources efficiently and economically, proportionality, and facilitating innovation and competition.

4. Our retail work is designed to make a real difference to firms and consumers. We focus our activities on four main aims: capable and confident consumers; clear, simple and understandable information available for, and used by, consumers; soundly-managed and adequately capitalised firms which treat their customers fairly; and risk-based regulation which enables us to focus our resources and activities on the most significant risks, through firm-specific and thematic supervision.

5. When implementing directives, our general approach is not to impose super-equivalent requirements unless this is necessary to achieve our statutory objectives and is justified on cost-benefit analysis grounds. Around 90% of the costs of our current conduct of business requirements for general insurance relate to directive requirements. Although the IMD applies only to intermediaries, the Treasury decided that in principle the IMD requirements should also be applied to insurers in order to avoid consumer confusion and to create a level playing field, and to a large extent we reflect this in our rules. The review of our regime (see section E below) is likely to lead to a more principles-based regime and some deregulation for those products where our market failure analysis and the results of our consumer research show this to be appropriate.

### C. THE TREASURY'S ROLE IN SETTING OUR REGULATORY SCOPE

6. The scope of our regulatory responsibilities is determined by the Treasury and Parliament. The Economic Secretary to the Treasury announced in August 2006 an inquiry to review the sale of travel insurance purchased as part of a package. Whether FSA regulation should be extended to cover additional products, such as travel insurance sold in connection with travel arrangements ("bundled travel insurance") and extended warranties, should in our view depend on whether there is a sufficient market failure and whether the cost-benefit analysis suggests this is a proportionate response. In this context we note that:

- (a) our review of general insurance conduct of business regulation and in particular the market failure analysis that we have carried out on commensurate type products (see section E) is relevant here;
- (b) regulation of bundled travel insurance and non-motor and extended warranties would be super-equivalent to the IMD;
- (c) consumers of bundled travel insurance products already have access to some protection. Insurers underwriting such insurance are subject to our prudential regulation, and customers of these products have access to the Financial Ombudsman Scheme (FOS) in the event of a complaint against the insurer (eg in respect of handling of a claim) and to the Financial Services Compensation Scheme (FSCS) should the insurer become insolvent. In addition, the Association of British Travel Agents (ABTA) has a Code of Conduct which is binding on its members. This requires members to ensure: that any insurance issued to a client is appropriate for the client's requirements; that clients are aware of the need to comply with the insurer's requirements and their duty to disclose all relevant information, such as pre-existing illness; and that clients are given certain documentation; and
- (d) in relation to extended warranties, the FSA is already responsible for the sale and administration of motor warranties, but not for the sale and administration of other types of extended warranty (ie mainly those on domestic electric goods). It should be noted, however, that some extended warranties do not constitute contracts of insurance and would therefore not fall to be regulated by the FSA in any case even if the Treasury were to extend regulation to include extended warranties for non-motor goods. But in a similar way to that outlined above, consumers have some protections through access to the FOS and the FSCS. Furthermore, the sale of extended warranties on domestic electrical goods is already subject to regulation under the Supply of Extended Warranties on Domestic Goods Order 2005/37.

7. The Treasury announced on 16 October that freight forwarders will be removed from the scope of our insurance regulation. This proposal is, we understand, based on advice the Treasury received from the Commission and will bring the UK into line with the position in most other member states.

### D. THE IMPLEMENTATION OF THE INSURANCE MEDIATION DIRECTIVE AND THE FSA'S REGULATORY RESPONSIBILITIES IN RELATION TO GENERAL INSURANCE

8. Following the decision by Treasury that the Insurance Mediation Directive (IMD) should be implemented by including insurance intermediaries within the FSMA regime, we took on responsibility for regulation of general insurance mediation in January 2005.

9. In addition to implementing the IMD we also implemented the Distance Marketing Directive and incorporated in our Insurance Conduct of Business sourcebook other directives that had already been implemented (Third Non-Life Insurance, Consolidated Life Insurance and Fourth Motor Insurance Directives). The aim was to provide a single coherent conduct of business regime for insurers and insurance intermediaries.

10. Because they are included in the FSMA regime, insurance intermediaries also have to meet the "threshold conditions" in FSMA and, as a consequence, various non-directive requirements, in particular: the Principles for Businesses and our rules on systems and controls, approved persons, and capital. We concluded that to have done otherwise would have led to FSA authorisation implying different standards depending on the type of firm.

11. Within this framework we aimed to apply a proportionate regime consistent with our statutory objectives and the principles of good regulation. We consulted fully on the options for implementation, including the possibility of a regime differentiating between lower and higher risk products. Following

consultation we decided not to bring in a differential approach to regulation. However, our rules on advice and disclosure do require firms to take account of the complexity of the products they are selling. There was broad support for this proposal.

12. In the light of feedback from the industry, and our own supervision experience, in October 2005 we consulted on removing some of the super-equivalent information requirements: the requirement on insurers to provide customers with information on their status and for non-advised sales the provision of a “demands and needs” statement. This was because the way in which insurers had implemented these regulations resulted in customers being given duplicate information and did not enhance consumer protection. As outlined in section E below, we have subsequently started reviewing the whole of our general insurance conduct of business (ICOB) rules.

13. In the longer term, changes to the regime may arise from discussions within the Insurance Mediation Experts Group of the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS). This Group will look at issues on which CEIOPS might make recommendations to the European Commission on the implementation of the IMD or improvement of its provisions. We will play an active part in this Group.

#### E. FSA PLANS FOR REVIEWING THE GENERAL INSURANCE REGULATORY CONDUCT OF BUSINESS (ICOB) RULES

14. As part of our commitment to ensuring that our approach to regulation is proportionate and effective, we are committed to carrying out post-implementation reviews to ensure that our regulations achieve the intended outcome for both consumers and firms. In September 2005 we announced that we would carry out a review of the general insurance conduct of business (ICOB) rules. Following feedback from the industry we announced in June 2006 that we were widening the scope of the review to look actively for deregulation opportunities. This is in line with our move towards more principles-based regulation and our commitment to the Better Regulation agenda.

15. As we recognised in our original consultation, the risk of consumer detriment varies between different types of insurance contract. As part of our thematic work we have established further evidence of this. In particular, there are greater risks to consumers relating to personal protection, such as payment protection and critical illness cover, than from other general insurance such as household and motor policies. Some parts of the industry are now also of the view that a differentiated approach would be appropriate—this is a change in their position since our original consultation. So, our review is considering whether our rules provide sufficient consumer safeguards for the sale of these personal protection policies. We are also examining whether the super-equivalent ICOB rules deliver benefits to consumers taking out household and motor insurance, and whether there is a case for deregulation in the case of these products, subject to the constraints imposed by directives.

16. Even if we decided to remove rules for the sale of these products, firms would still have to comply with our overarching principles of good business, including treating their customers fairly. We will continue to judge firms and their senior management in the light of these principles.

17. Work on our ICOB review is well under way:

- We are currently analysing the results of three pieces of consumer research, which have examined consumers’ use of the disclosure documentation required by our rules;
- We have completed initial market failure analyses for a sample of products. These suggest that there is scope for deregulation in relation to most general insurance products apart from four types of product—income protection, critical illness, term assurance (including pensions term assurance) and payment protection insurance.
- We are examining all areas of super-equivalence in the ICOB rules in the light of our consumer research and market failure analyses. If we find that these are not justified for certain products, or that they are ineffective, we will remove them. We are seeking regular feedback from the industry as this work progresses.

18. We will issue a report in the first quarter of 2007 setting out our broad conclusions. If, as seems likely, we propose changes to ICOB, we will consult on these changes in the second quarter of 2007. They will be subject to the usual procedures, including cost/benefit analysis.

*November 2006*

---

#### Memorandum submitted by Zurich Financial Services

Zurich Financial Services is an insurance based financial services provider with a global network that focuses its activities on its key markets in North America and Europe. We also have extensive operations in Latin America and Asia/Pacific. Founded in 1872, Zurich is headquartered in Zurich, Switzerland. Zurich has offices in more than 50 countries and employs about 55,000 people.

The core of our business is General and Life Insurance. We provide insurance and risk management solutions and services for individuals, small and mid sized businesses, large corporations and major multi-national companies. We distribute third-party financial service products.

#### EXECUTIVE SUMMARY

1. Zurich Financial Services supports UK General Insurance regulation as it provides a necessary enforcement presence, which ensures integrity within the market. Customer protection, fair treatment and satisfaction should be at the centre of every firm's culture and enforced proportionally. We believe that non risk-based pre-emptive enforcement by way of rules based regulation does not achieve this.

2. It is our view however that General Insurance regulation is not presently aligned with what the government, industry or the customer wants. 2006–07 represents the single biggest opportunity for meaningful regime change by ensuring 1) true risk-based regulation is pursued, 2) a structured move where appropriate towards principles, not detailed rules, 3) "lighter touch" supervision, and 4) development of industry led solutions.

3. We have reviewed and fully support the Association of British Insurers (ABI) customer research on the impact of regulation on the customer published in March 2006—*"The Regulation of General Insurance Sales: One Year On"*. In particular, we support the conclusions from our own experience of conduct of business regulation since January 2005. These include the benefits not justifying the costs, customers being unaware of the new regime and paying little attention to the required information, rules that are too prescriptive and not in accordance with the FSA stated aim of Principle's based regulation.

4. The development and application of EU directives should work to shape a European marketplace and provide a set of standards that apply across that market. UK implementation of the EU Directives has put us out of kilter with the rest of Europe and could significantly damage the UK Insurance industry's ability to be competitive in this emerging market. Not only will this impact the Domestic Product returns but also acts to discourage future investment in our Domestic market.

#### FEEDBACK

##### A. *The current extent of regulation of the insurance market*

5. We welcome the FSA's post-implementation review into the effectiveness of its general insurance conduct of business regime throughout 2006. The review builds on the regulators move towards more principles-based regulation in line with its commitment to drive "Better Regulation".

6. Experience of general insurance regulation so far suggests there are greater risks to consumers in relation to personal protection, such as payment protection and critical illness cover, than from other retail general insurances such as household and motor policies. We do support the FSA's increased focus on whether the Insurance Conduct of Business (ICOB) rules provide sufficient consumer safeguards for the sale of protection policies. We do question however whether ICOB delivers benefits to consumers taking out household and motor insurance.

7. We also propose that the third tier—commercial general insurance—which includes products such as Property, Business Interruption and Employers and Public Liability policies present significantly less risk still. The UK interpretation of the Distance Marketing Directive has widened the application to cover mixed use purchases, which means some typical "commercial" products bought in relation to a customers "trade, business or profession" must now be treated as retail.

8. There is disparity between common risk (natural) customer groupings, retail/commercial groupings (FSA defined) and eligible/ineligible complaints (Financial Ombudsman Service (FOS) defined). A single product could be sold to both a retail ineligible customer and a commercial eligible customer, which presents a myriad of problems and can lead to further confusion for customers.

9. If treated unfairly, customers "vote with their feet" when purchasing general insurance products. The general insurance market shows little evidence of consumer detriment and customers have been picking up the costs of regulation with an estimated £2.50 added per policy sold in the UK. Customers primarily look for price, cover, a trusted brand, convenience, simplicity and speed when purchasing insurance products.

10. Customers will recognise the impact of regulation via overly complex documentation and inhuman telesales processes, which increase customer apathy. The challenge is to deliver a more customer focused process and service.

11. We believe that there is also a misalignment and inconsistency between FOS and FSA messaging. The FOS is basing decisions on information contained in policy summaries, which is forcing companies to increase the content of this document. This conflicts with the FSA emphasis of "less is more".

12. There is no doubt that there have been a number of positive features of regulation since 14 January 2005. Consistency of enforcement is improving and governance of the distribution networks has improved. It is clear that general insurance intermediaries continue to face a number of challenges in their newly regulated market. This is arguably having a considerable impact on the structure of the market with increased consolidation, potentially leading to less customer choice.

13. The move to principles-based regulation is a positive step but the “devil will lie in the detail”. The current approach to Treating Customers Fairly provides some insight into how principles-based regulation can lead to uncertainty and the potential for inconsistency in application. Recognition that not all parts of the market require the same level of protection should be evident, particularly where competition is working well.

14. The different characteristics of general insurance distribution channels and the need to reverse “gold plating”, particularly in the application of the Insurance Mediation Directive to direct writers, should be acknowledged. The regulatory burden on intermediaries and direct writers is highlighted by the fact that the Insurance Mediation Directive (8 pages) and Distance Marketing Directive (9 pages) morphed into the FSA ICOB rulebook (194 pages).

*B. The need for, and potential effects of, extending regulation to the bundled travel insurance and extended warranty markets*

15. We feel that travel insurance sold as part of a package and insured extended warranty products should be bought within scope of a deregulated market.

Substantial numbers of consumers value the packaged element of holiday insurance when it is bought with a trip. This delivers convenience, which is a key point for the customer. The large online markets for travel, motor, home and pet insurance deliver a wide range of choice for the consumer so we view a similarity between the travel market and the rest of the general insurance market.

It is our view that as insured extended warranty products is covered by The Supply of Extended Warranties on Domestic Electrical Goods Order 2005 and the Department for Trade and Industry supplementary guidance then further regulation in this market would not be appropriate.

16. We consider the creditor/PPI market to be a special case where the long term financial well being of the consumer is at stake and as a consequence this market deserves a more strict regulatory regime more in keeping with the risks to the consumer.

*C. The form any proposed future regulation might take, including models for non-statutory regulation.*

17. Industry creates approximately £20–40 billion of red tape in order to demonstrate administrative compliance eg assurance reporting and record keeping. It is our preference for industries to regulate themselves and to develop creative alternatives to statutory regulation. We encourage an ethos that starts from the basis that efficient markets are preferable to regulation. Whilst we have seen an increase in consumer protection standards, there remains the overarching concern that regulation frustrates creativity and innovation. We do not believe that a proportionate balance has yet been struck. When building regulation, emphasis should also be placed on the law of diminishing returns and identify where costs begin to outweigh benefits. We are encouraged by the action that the FSA is seeking to take to redress that balance.

18. It is our view that government, regulators, industry and consumers should focus on achieving “optimal” levels of protection via risk-based regulation with an emphasis on relationships of trust and the customer.

19. Our understanding is that the FSA wishes to facilitate greater use of industry guidance as part of the move towards principles-based regulation. The FSA has published a discussion paper “FSA Confirmation of Industry Guidance” and we will be looking to respond both directly and via the ABI. Whilst we support the concept, we feel that there is potential for FSA “confirmation” of industry guidance to be misconstrued by both the regulator and regulated. In particular, we are concerned that the FSA supervisory teams and the Financial Ombudsman Service have a consistent approach to applying industry guidance. The understanding is that industry guidance would be a substitute for current FSA guidance. Whilst putting guidance in the hands of the industry is welcomed, it may not lessen the regulatory burden. Indeed, there is the potential to increase confusion among new and existing firms as to the source of the relevant regulation, whether statutory or self-imposed.

20. Contract certainty is a positive example where the FSA has asked the industry to lead change and is a public demonstration of the FSA’s faith in the market generating solutions to industry issues. This is a solution, which should be encouraged for future areas ordinarily subject to regulatory intervention.

## Memorandum submitted by Citizens Advice Bureaux

### SUMMARY

- Citizens Advice believes that there is a case to bring extended warranties and bundled travel insurance under the umbrella of FSA regulation, the case for this is arguably supported by the fact that regulation has been developed to cover a specific area of extended warranties—those relating to domestic electrical goods, on the grounds that the market is not working for consumers.
- The detailed work by the Office of Fair Trading and Competition Commission which led to the regulation of extended warranties on domestic electrical goods recognised that the unregulated market was anti-competitive and in order to ensure fair competition while recognising the practical advantage of bundled sales clear information is needed at the point of sale, and adequate cancellation rights should be provided.
- Citizens Advice supported this legislation, and reiterates that in order to be a confident consumer you must be able to exercise informed choice and have the ability to shop around for the best deal. Citizens Advice believes that there is a contradiction between the recognition of a need for regulation on extended warranties on domestic electrical goods and the decision to exclude extended warranties as a whole from the FSA's remit.
- Citizens Advice believes that the anti-competitive nature of this market has led to significant consumer detriment. Our evidence shows that bundled travel insurance and extended warranties are often mis-sold, claims on policies are often rejected due to various exclusion clauses, and that consumers are often unaware of exactly what they are buying in terms of the precise level of protection provided.
- Citizens Advice believes that these problems cannot be tackled by voluntary codes alone and that statutory regulation is essential.

### 1. Introduction

1.1 The Citizens Advice Bureaux (CAB) network is the largest independent network of free advice centres in Europe, providing advice from over 3,200 outlets, ranging from GPs' surgeries, hospitals, community centres, county courts and magistrates courts, and mobile services both in rural areas and to serve particular dispersed groups. Citizens Advice also acts as the UK European Consumer Centre (ECC) providing advice and information helping consumers to resolve disputes within the European Union.

1.2 The service has two equal aims:

- to ensure that individuals do not suffer through lack of knowledge of their rights and responsibilities or of the services available to them, or through an inability to express their needs effectively;
- and equally, to exercise a responsible influence on the development of social policies and services, both locally and nationally.

1.3 In 2005–06 the CAB service dealt with 5.2 million new enquiries. Of these enquiries, 23,649 relate to insurance products, including 449 on extended warranties and 1,946 on travel or holiday insurance.

1.4 CAB clients are likely to be on low incomes. Recent research for Citizens Advice by MORI shows that CAB clients are predominantly in social groups DE and more likely to be tenants of social housing than the population as a whole.<sup>1</sup>

1.5 The Treasury Select Committee's inquiry into FSA Insurance Regulation focuses on three areas:

- The current extent of regulation of the insurance market;
- The need for, and potential effects of, extending regulation to the bundled travel insurance and the extended warranty markets;
- The form any proposed future of regulation might take, including models for non-statutory regulation.

1.6 Our comments briefly cover each point, outlining the background to limits of existing regulation, highlighting the consumer detriment caused by the lack of regulation in the two areas identified and comments on preferred forms of regulation.

1.7 Should an opportunity be found to have a longer inquiry on this issue, Citizens Advice would be in a position to provide a more informed and comprehensive submission.

---

<sup>1</sup> *Unmet need for Citizens Advice Bureaux*, MORI, September 2004.

## 2. Background on existing regulation

2.1 The FSA became the regulator of general insurance in January 2005. In setting the scope of the FSA's regulatory powers, HM Treasury decided, after consultation, to exclude bundled travel insurance and extended warranties.

2.2 The FSA Handbook, which sets out the FSA's legislative and other provisions made under powers given to it by the Financial Services and Markets Act 2000, gives examples of the terms under which an extended warranty may be considered a contract of insurance and therefore fall under their regulatory remit. The Handbook is extremely complex and clearly industry-facing, and the limits of consumer protection as defined within are therefore difficult to interpret. In basic terms it sets out that the FSA would be likely to classify a contract of sale containing a warranty as a contract of insurance only if: a) it offered protection beyond the buyer's statutory rights or; b) was sold by third party. The Handbook goes on to specify various technical caveats and qualifications.<sup>2</sup>

2.3 Consumers therefore remain largely exposed in purchasing extended warranties at the point of sale and, similarly in purchasing bundled travel insurance. Citizens Advice believes that there is a case to bring these products clearly under the umbrella of FSA regulation.

2.4 The Office of Fair Trading began the process leading to the regulation of extended warranties on domestic electric goods (DEGs) in October 2001 when it launched a review of the issue, triggered by the results of a mystery shopping survey.

2.5 The review, published in July 2002, identified key areas of concern:

- A lack of effective competition in the extended warranty market;
- A lack of awareness along consumers of their options regarding where they can buy extended warranties;
- Inadequate consumer protection in the market.<sup>3</sup>

2.6 The review formally referred the issue to the Competition Commission. The Commission's report, *Extended warranties on domestic electrical goods*, was presented to parliament by the Secretary of State for Trade and Industry in December 2003. Regulations based on the report's findings were eventually put before parliament in January 2005, coincidentally at the same time as the FSA took on its expanded role which excluded extended warranties.<sup>4</sup>

2.7 The detailed and extensive work carried out by the OFT and the Competition Commission, as well as the length of time taken to complete their work, highlights the importance and complexity of this issue, especially as the work was limited to just one specific type of extended warranty. The strength of the consumer protection measures passed into law for this relatively narrow area draws a sharp contrast with the lack of regulation for other types of extended warranties and, indeed, bundled travel insurance.

2.8 The practical effect of the January 2005 Statutory Instrument was to ensure that:

- retailers must give consumers information about their statutory rights, cancellation rights and details of the warranty, including whether or not their warranty provides financial protection if the company goes bust and whether it terminates in the event of a claim;
- retailers must show the price of the extended warranty alongside electrical goods in store, in catalogues, on websites and in print adverts;
- retailers must offer the extended warranty on the same terms for 30 days if the consumer chooses not to buy it there and then. Any discounts tied to the purchase of the extended warranty would also be available for 30 days;
- retailers must inform customers of their rights to buy a warranty elsewhere, and that the electrical item they bought may already be covered by their own household contents insurance;
- consumers have the right to cancel the warranty within 45 days and get a full refund, if they have not made a claim. If they have made a claim on the warranty, they have the right to cancel and get a *pro-rata* refund at any time up until the end of the warranty agreement.

2.9 Citizens Advice strongly welcomed these measures to protect consumers against the mis-selling of extended warranties for DEGs. But in its limited scope this SI exposes a wider need, reflected in the limitations on FSA regulation. Citizens Advice evidence demonstrates that regulation is needed across the extended warranty and bundled travel insurance market. However, regulation will require a broader scope to accommodate the peculiarities of many of the products involved.

2.10 At present extended warranties can fall into three categories:

- FSA regulated extended warranties (when the terms set out in the FSA Handbook, as above, are met);

<sup>2</sup> *FSA Handbook, Perimeter Guidance Manual 6:[nbsp]Guidance on the Identification of Contracts of Insurance, PERG 6.7: Examples*, FSA, available at [www.fsa.gov.uk/handbook/](http://www.fsa.gov.uk/handbook/)

<sup>3</sup> *Extended warranties on domestic electrical goods: A report of an OFT investigation*, OFT, July 2002.

<sup>4</sup> *Statutory Instrument No 37 2005: The Supply of Extended Warranties on Domestic Electrical Goods Order 2005*.

- OFT regulated extended warranties (on domestic electrical goods only); and
- Regulation-free extended warranties.

2.11 Not only is this confusing for consumers but it is also a highly inefficient system. There are gaps and duplication in the regulation, and the gaps are demonstrated by CAB evidence to be a source of consumer detriment. There is a clear need to simplify this regulation and to make it more effective.

### 3. Consumer detriment and the need for further regulation

3.1 CAB evidence demonstrates considerable consumer detriment caused by the lack of regulation for extended warranties and bundled travel insurance. The problems can be divided into two sections: cancellation rights and; lack of information at the point of sale.

#### CANCELLATION RIGHTS

3.2 The absence of cancellation rights means that consumers are vulnerable to pressure selling techniques—they cannot cancel their purchase subsequent to the actual transaction. This is in turn compounded by the lack of information at the point of sale to inform consumers of their rights, eg the right to refuse the bundled travel insurance, or to buy a warranty from elsewhere. Retailers are therefore granted an anti-competitive advantage because they can sell warranties marketed with the goods the consumer is buying, from which the consumer has no right to withdraw after the sale.

A CAB client in Surrey reported problems when buying a holiday from a local firm. She had wanted to choose her own travel insurers as she wanted to take out an annual policy at a later date in order to cover future holidays as well. The travel agents would not allow this however and insisted on her using their own or quoting existing insurance.

A Durham CAB reported that their client was told that she had to return a form in order to be allowed to refuse an extended warranty from a catalogue supplier. Despite having done so she is now being chased for the cost of the warranty as if it is a debt.

3.3 The table below illustrates the range of current legal cancellation rights in the UK, as a contrast with the absence of these rights on extended warranties and bundled travel insurance.

**Table 1: UK legislative cancellation rights at a glance<sup>5</sup>**

<i>Subject</i>	<i>Statutory cancellation period</i>	<i>Cancellation period begins</i>	<i>Method of cancellation</i>	<i>What is not covered</i>
Doorstep selling	7 Days	Day after purchase	In writing	Solicited sales
Timeshare	14 days	Day after purchase	By notice	Holiday clubs
Distance selling—goods and services including services	7 working days	On receipt of goods or from the day following purchase of the service	In writing or durable form	Where the transaction includes a face-to-face element
Distance selling—financial services including credit	14 days (30 days for life insurance)	From the day following purchase of the service	In writing or durable form (and orally where the trader permits)	Where the transaction includes a face-to-face element
Credit	5 days	The day after receiving the cancellation notice	In writing	Face-to-face transactions and transactions concluded on trade premises
Extended warranties on domestic electrical goods	45 days	Day of purchase	By notice orally or in writing	Other extended warranties and domestic electrical goods warranties that are distant sales
Fuel	14 days	The day after purchase	Any	Non-oral sales, eg internet
Telecoms	10 working days	The day the switch of supplier is processed	Any	New lines, second lines, internet, mobile, broadband

3.4 In all the situations outlined here, there is a requirement for the trader to provide the consumer with information about their cancellation rights. Where this is not provided, the cancellation period can be extended. This again contrasts starkly with the absence of rights on extended warranties and bundled travel insurance.

<sup>5</sup> *Can You Cancel It?*, CAB Evidence Briefing, December 2005.

---

## LACK OF INFORMATION

3.5 There is no requirement for detailed product information to be provided on extended warranties or bundled travel insurance at the point of sale. Consumers are often therefore unaware of exactly what they are buying. Deals offering cashback on unclaimed warranties are often used as a further incentive at the point of sale. CAB evidence shows that consumers can be misled and that these offers often do not pay out.

A CAB in Yorkshire reported that their client had taken out extended cover for any costs in cleaning his three piece suite. The deal offered a refund if he had not claimed after five years. He returned the documents as required but has had the claim rejected on the ground they cannot find his application and, having sent it off, he no longer has any proof.

A CAB client in London, who receives benefits and looks after a severely disabled child, was persuaded to spend £80 on a five-year warranty for a bed. She was told she could have a refund if she did not claim for the five years but not that she had to register this. The five years is now up but the refund has been refused.

A Surrey CAB reported that their client had bought a £500 warranty on the basis he could claim the cash back if it was not used at the end of the period. He had not been told he had to register it at the time of the purchase and now finds he cannot claim.

3.6 As demonstrated by CAB evidence, people will spend significant sums in order to safeguard their purchase only to find that their warranty/insurance does not cover them for a specific eventuality. Consumers presume that they are insuring themselves against future risk but are unaware that they do not have any regulatory back-up. This uncertainty and confusion is, perversely, exacerbated by the fact that extended warranties on DEGs are regulated.

A Kent CAB's client purchased a sofa from a high-street furniture store specialising in leather goods. The sofa cost £899 and she paid a further £200 for a warranty, which she was told would cover any damage or inherent defects for five years. Four months later a seam on the arm of the sofa started to split and the stuffing came out. The client was advised to claim the cost of repair but was turned down on the grounds that the warranty covered leather goods only and client's sofa was vinyl. In the meantime more seams had split.

A young mother approached a CAB in London after her 18-month-old baby had fallen head first onto the pavement when a back wheel came off her relatively new pushchair. She had been told by the high street store which sold the item that she would have to pay for the repairs despite the fact that it was defective. The 12-month warranty she had for free repairs was rejected.

A CAB client in Gloucestershire reached a stalemate with the company from whom she is claiming a refund of the £175 paid for a warranty bought from a well-known furniture store. They deny she sent the tear-off slip to activate their no-claims refund scheme.

3.7 Without appropriate information it is difficult for consumers to determine the exact circumstances under which they are covered and how much of a back-stop it requires. CAB evidence shows cases where clients have been left with useless warranties because the vendor has gone bust. There are no provision for this eventuality.

A CAB client in Durham bought a four year warranty with a washing machine in 2000. She returned the relevant paperwork to collect the vouchers she was entitled to because she had never had to make a claim but now finds the company has gone out of business. The washing machine has now broken down and she has no vouchers to use to buy a replacement.

A CAB in the North West reported that their client had taken out a four year cash back warranty for £209.99, which was due to expire in September 2005. He subsequently heard from the liquidator that the company has gone into receivership and he is only likely to get £4.19.

A CAB client in Bedfordshire received free repairs on the second-hand car she bought but the company have now stopped trading. She had paid for a 12 month warranty but when she contacted the warranty company about the £2,000 she needed for essential repairs they said they were not paid by the dealer, so the warranty is not valid.

3.8 There are many extended warranties on the market that represent little value for money. These warranties can cover things like mechanical breakdown and accidental damage for items such as sofas and second hand cars. Some warranties offer consumers no more protection than their entitlements under normal consumer protection legislation. Similarly, consumers may already be covered by their household contents insurance and have no need for a warranty. Sometimes it is very unlikely that the product will break down, leaving little need for an expensive warranty. Ultimately consumers have a right to goods that work, and to choose between a refund, repair, replacement or part refund if they are faulty. Retailers must provide these rights anyway. Information at the point of sale should therefore clearly set out what, if anything, is being provided beyond your statutory rights under sale of goods legislation, and the limits of the policy, as is the case for DEGs.

3.9 It should be noted of course that most policies sold are never tested by the consumer—this only occurs when things go wrong and a claim is made against the policy.

#### 4. *Forms of Regulation*

4.1 Citizens Advice believes that there is strong evidence of consumer detriment in the market for extended warranties. FSA insurance regulations should be extended to cover extended warranties and bundled travel insurance.

4.2 Currently consumers purchasing extended warranties on domestic electrical goods do have statutory rights to information, and a cooling off period of 45 days. But these rights are not available to consumers purchasing extended warranties on other items, such as cars or furniture. And those rights which consumers of domestic electrical goods warranties do have have to be enforced by them individually. In addition, there is no clear regulatory oversight of the extended warranty market which would ensure that consumer detriment could be prevented by setting standards for disclosure and fair treatment to be met by all retailers.

4.3 A voluntary code would at most cover increased provision of information at the point of sale and possibly a short cancellation period. Though beneficial this would not provide the necessary means to tackle bad practice, and many inappropriate and ineffective products would still be sold and would remain untested by claims.

4.4 In addition to this, the OFT's 2002 review of the markets in extended warranties on DEGs found that "the British Retail Consortium Code of Practice does not seem to be working<sup>6</sup>".

4.5 Voluntary requirements on the provision of information and the ability to cancel purchases are positive but can be met by unscrupulous businesses without having any real benefit for the consumer. For example, the necessary information could be provided to consumers in such a complex manner that the effect is to obscure the relevant passages. CAB evidence would suggest that any voluntary code is likely to suffer from these sorts of abuses. The solution is to back up such requirements with statutory regulation.

4.6 Finally, extending the scope of FSA regulation clearly to extended warranties of all kinds and travel insurance would have the added benefit for consumers of access to the Financial Ombudsman Service in the event of complaints. This could provide a powerful incentive to fair treatment of consumers which does not currently exist, as our case studies in this submission illustrate.

November 2006

---

### Memorandum submitted by the Financial Services Consumer Panel

#### THE CURRENT EXTENT OF REGULATION OF THE INSURANCE MARKET

The Panel regards the FSA's performance in relation to general insurance regulation as acceptable. There has been some early thematic work, the results of which have been disappointing. The Panel expects to be briefed on the results of the FSA's general insurance effectiveness review towards the end of 2006 which will judge the effectiveness of the regime itself, and whether it is delivering policy objectives to consumers.

Bundled travel insurance and extended warranties are not currently regulated by the FSA. The Panel believes some products in these markets offer poor value to consumers, as they are over priced. This suggests a lack of effective competition in the market place due to consumers not being aware of other similar cheaper products and lack of proper advice in the sale of these products.

#### THE NEED FOR, AND POTENTIAL EFFECTS OF, EXTENDING REGULATION TO THE BUNDLED TRAVEL INSURANCE AND EXTENDED WARRANTY MARKETS

We welcomed HM Treasury's announcement in December 2001 that mortgage advice and general insurance were to be regulated by the FSA. The Panel had argued in favour of these changes since its formation in December 1998. However, we were disappointed that bundled travel insurance and extended warranties were not covered and wrote to the then Economic Secretary, Ruth Kelly, in January 2002 to raise our concerns. We thought then and still believe that such sales should be regulated by the FSA.

As we stated at the time in our letter to the Economic Secretary, in the case of travel insurance we were concerned that consumers could be charged four or five times as much for the same or an inferior level of insurance cover by a tour operator or travel agent as they would be charged by an independent travel insurer. In addition many consumers who travel abroad two or three times a year would be much better off with annual travel insurance policies rather than single trip insurance policies—yet travel agents and tour operators do not give this vital advice.

Research conducted by London Economics for the Office of Fair Trading<sup>1</sup> showed that travel agents and tour operators sold the greatest number of policies in 2004, 30% of all policies sold. The research found that travel agents tended to sell a disproportionately high level of single policies relative to the market average and that travel insurance bought from a travel agent can be up to four times more expensive than available best buy policies.

---

<sup>6</sup> *Extended warranties on domestic electrical goods: A report of an OFT investigation*, OFT, July 2002, Page 2.

<sup>1</sup> Research into Payment Protection Insurance in the UK (non confidential version) prepared for the Office of Fair Trading by London Economics October 2006 page 178.

Our letter to the Economic Secretary stated that extended warranties routinely offered by retailers when consumers buy electrical goods can be ridiculously expensive. For many products the chances of having to pay this much for repairs during the warranty period are small.

Reliability data published by Which?<sup>2</sup> in respect of domestic appliances showed that 92% of fridge-freezers, 90% of cylinder vacuum cleaners and 80% of tumble driers<sup>3</sup> did not require a repair in the last six years. In the case of audio visual goods 97% of DVD players, 96% of digital cameras and widescreen IDTVs did not require a repair in the last six years. As modern appliances become more reliable the need for extended warranties has to be questioned. In addition consumers may be unaware that extended warranties are available from a number of sources. Some manufacturers offer their own extended warranties, free or cheaper than those offered by retailers, and extended warranties are also available from credit card companies and insurers.

Extended warranties are sold by shop staff with little knowledge of the product, who are often incentivised by commission. The Office of Fair Trading<sup>4</sup> investigation into the market for extended warranties identified four areas of concern:

- the similar behaviour of electrical retailers limits consumers' ability to make accurate assessments of the value of buying extended warranties;
- a lack of competition in the extended warranty market;
- consumers were largely unaware of their options regarding where they could buy extended warranties;
- consumer protection within the market was inadequate.

In addition there have been problems with extended warranty schemes not being backed by proper insurance policies or funds being put aside and ring fenced to cover obligations. So, if the company that has issued them goes out of business, consumers are left with worthless warranties, with no access to redress to pay any claims or refund their premiums. This was the case when Tempo, the electrical and consumer goods retailer, went into administration in September 2001. The Tempo extended warranties had not been backed by insurance, nor had funds been put aside to cover these obligations, so its customers were left with worthless warranties.

#### VIEWS ON FUTURE REGULATION

As secondary insurance such as pet plans sold by vets and dental insurance sold by dentists is now regulated by the FSA, it is an anomaly that travel insurance sold by travel agents or tour operators as part of a package are not covered by the FSA.

On the grounds of consumer protection extended warranties should also be regulated by the FSA. Consumers who purchase extended warranties have taken positive steps to protect their goods. Ironically, if the retailer fails to ensure that those warranties are backed by insurance or to ring fence funds to cover the obligations, there is no protection for these consumers.

*November 2006*

---

#### **Memorandum submitted by the Finance and Leasing Association**

1. The Finance & Leasing Association (FLA) would like to take the opportunity to respond to the Treasury Committee announcement that it intends to undertake a short inquiry into the scope of Financial Services Authority (FSA) insurance regulation following the implementation of the Insurance Mediation Directive (2002/92/EC) in January 2005.

2. In view of the limited timescale available, our comments are inevitably both limited and provisional.

3. The FLA is the main representative organisation for the asset finance, consumer credit and motor finance sectors in the UK. Our members comprise banks, subsidiaries of banks and building societies, the finance arms of leading retailers and manufacturing companies, and a range of independent firms. The facilities provided by FLA members include finance leasing, operating leasing, contract hire, hire purchase, conditional sale, personal contract purchase plans, personal lease plans, secured and unsecured personal loans, credit cards and store cards.

4. FLA members achieved £87.3 billion of new business in 2005. Of this, £27.2 billion was provided to the business sector and UK public services and represented 30.4% of all fixed capital investment in the UK in 2005 (excluding real property). The remaining £60.1 billion was provided to the consumer sector and FLA

<sup>2</sup> Which? December 2005.

<sup>3</sup> *Market Impacts of Regulation General Insurance*, CRA International 2006.

<sup>4</sup> *Extended Warranties on domestic electrical goods* A report on an OFT investigation July 2002.

members represented 25.5% of all unsecured lending in the UK last year. Included in the above total is £18.6 billion of finance provided to the motor sector. FLA members financed at least 50% of all new car registrations in the UK in 2005.

5. FLA full members sell many forms of general insurance to customers, most particularly payment protection insurance but also GAP (a form of general insurance that fills the “gap” between the amount owing under the finance agreement and the insurance cover for a motor vehicle).

Members also sell Extended Warranties. The insurance is sold through both direct and intermediary introduced channels. The majority of full FLA members sell general insurance as company agents. Amongst our associate members we have a number of general insurance underwriters.

6. The insurance products sold by FLA members are typically secondary or tertiary customer purchases. For example, a customer might enter a dealership to purchase a car (primary purchase), they might then decide to finance the cost of the car and will enter into a credit agreement (secondary purchase), in addition they might then choose to take out a payment protection insurance product to protect their loan repayments in the event that they are not able to make them (tertiary product).

7. The Treasury Committee seeks submissions of written evidence focusing on the following:

- The current extent of regulation of the insurance market;
- The need for, and potential effects of, extending regulation to the bundled travel insurance and extended warranty markets;
- The form any proposed future regulation might take, including models for non-statutory regulation.

#### EXECUTIVE SUMMARY

8. There has been a significant regulatory impact on a large number of previously unregulated firms. All contracts of insurance (including travel insurance) should be within the scope of regulation regardless of the premium amount. However, we do not believe that extended warranties, a product already regulated, should be included in the scope of FSA regulation.

9. FSA rules have imposed extra information, authorisation, prudential and training requirements on those caught by their insurance mediation regime and has imposed a considerable level of detail in the rules. It is perceived as an overly paternalistic regime with an ever increasing reliance on over-regulation, consumer protection, reviews of disclosure and selling practices and Government imposed product designs. The impact on customers varies markedly between different types of insurance and costs are now higher for customers of most general insurance products.

10. Regulation should not impinge on competition by making products and services the same. Insurance products are not simply commodities like loaves of bread in a Supermarket, sold simply on price, but varied products designed to suit differing consumer needs.

11. We do not believe the time is right to review the regulatory regime for extended warranties. Moving regulation to the FSA would simply mean increased costs for all concerned without any evident benefit to the consumer. The costs of meeting current FSA rules for extended warranties sold through a high street distribution channel would be disproportionately high for the potential benefits to consumers.

12. Compliance is consistent across the industry and consumers also presently benefit from the FSA regulation of the insurers in terms of product disclosure and are afforded the safeguards of the Financial Services Compensation Scheme and the Financial Ombudsman Service.

13. In April 2006, the European Commission referred six member states to the European Court of Justice for not having implemented the Insurance Mediation Directive into their national law. We believe that the Treasury Committee could usefully examine the insurance regulatory regimes in some other member states to determine if the UK has a heavier, or “goldplated” approach to the implementation of the Directive than have other member states, potentially leading to a competitive disadvantage for UK businesses.

14. We believe that the Financial Services Authority should be encouraged rapidly to replace over-prescriptive rules with principles; an action which we understand it has an appetite to achieve.

#### THE CURRENT EXTENT OF REGULATION OF THE INSURANCE MARKET

15. Statutory regulation of general insurance was introduced to implement two EU Directives—the Insurance Mediation Directive and the Distance Marketing Directive. The Insurance Mediation Directive is intended to create a single market in insurance via a “passport” for EU retail insurance intermediaries. In return for the passport Member States are required to set certain minimum standards for taking up and continuation of the business of insurance mediation. The Directive was fully implemented by the UK on 14 January 2005 by the Insurance Mediation Directive (Miscellaneous Amendments) Regulations 2003, the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No 2) Order 2003 (S.I. 2003/1476), the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2004 (S.I. 2004/1610) and by FSA rules.

16. It should be appreciated that following the implementation of the Insurance Mediation Directive in January 2005 there has been a significant regulatory impact on a large number of previously unregulated firms. Experience over the past 22 months has led the FLA to review its views submitted during the consultation on the regulation of insurance mediation in January 2003. Most of our views remain the same, but there are some variations in the light of experience. Whilst we were involved in work with the FSA's Advisory Group at the time, decisions on scope had already been made by HM Treasury.

17. We believe it is right that insurance providers and intermediaries who are in the business of providing financial advice to customers should be within the scope of FSA regulation. It is also our view that all contracts of insurance (including travel insurance) should be within the scope of regulation regardless of the premium amount. However, we do not believe that extended warranties require further regulation, and our reasons are given in the section on the need for, and potential effects of, extending regulation to the bundled travel insurance and extended warranty markets below.

18. Whilst we agree that all contracts of general insurance should be subject to regulation by the Financial Services Authority, we believe that the regime should take into account that advice is not given in all cases and many general insurance products are sold by providing information to the customer so that s/he can make an informed decision as to whether the insurance cover is sufficient for his or her needs. This is particularly important where the insurance is sold as a secondary or tertiary product by intermediaries for whom insurance is not a primary activity.

19. We agree that a distinction needs to be made between *introducing* and *providing* advice. There is sometimes an assumption made, however, that all insurance sales involve an element of advice. This is not the case. Where insurance is sold through a retail/dealership outlet (for example, payment protection insurance and GAP) the products do not typically compete with one another because the insurance follows the loan, and the outlet does not offer a choice of insurers.

20. However, the rules imposed by the FSA have imposed extra information, authorisation, prudential and training requirements on those caught by their insurance mediation regime and has imposed a considerable level of detail in the rules. It is perceived as an overly paternalistic regime with an ever increasing reliance on over-regulation, consumer protection, reviews of disclosure and selling practices and Government imposed product designs which could undermine the competitiveness of UK firms and the diversity of products available to consumers, that actually starts to damage competition and innovation, so disadvantaging the very people whose interests should be safeguarded.

21. The impact on customers varies markedly between different types of insurance and costs are now higher for customers of most general insurance products. Moreover, it appears that customers are not particularly interested in most of the information they have to be given because of regulatory requirements.

22. The Insurance Mediation Directive implementation also highlights the risk from super-equivalence resulting in the Directive having an impact on areas not originally identified as being a problem and therefore producing extra costs with little or no obvious benefits. The Association of British Insurers has highlighted these additional costs to consumers in its report *The Regulation of General Insurance Sales: One Year On* published in March 2006.

23. Customers for general insurance products can switch insurer very easily. Regulation should not impinge on competition by making products and services the same. Insurance products are not simply commodities like loaves of bread in a supermarket, sold simply on price, but varied products designed to suit differing consumer needs. The regulatory framework should therefore be principles-based looking at what should happen, rather than dictating how it is exactly to be achieved. Companies should be permitted to adopt approaches to suit their circumstances and the needs of their customers. Customers are less willing to shop around when the sales process is prescriptively regulated since all products seem to be pretty much the same in a particular field. They are thus denied the opportunity to find the best deal for their circumstances.

#### THE NEED FOR, AND POTENTIAL EFFECTS OF, EXTENDING REGULATION TO THE BUNDLED TRAVEL INSURANCE AND EXTENDED WARRANTY MARKETS

24. We note that the terms of reference of the inquiry include the question of whether regulation needs to be extended to extended warranty markets. The Committee should be aware that between July 2002 and December 2003 the Competition Commission Investigated the extended warranties market in relation to domestic electrical goods following a reference by the Office of Fair Trading. By any measure, their investigation was exhaustive and comprehensive. The Commission concluded that regulations were required to ensure that customers were provided with wider opportunities to assess their need for an extended warranty and to choose between different extended warranty offerings. Customers should also be provided with the information necessary to make well informed decisions regarding their purchase of extended warranties.

25. After a lengthy period of detailed consultation, regulations designed to achieve these objectives were introduced in April 2005, at which time it was announced that the market would be further reviewed after two years, ie the Spring of 2007 in order to determine whether their objectives had been met. It is accordingly

premature for the Committee to consider this particular aspect now and we therefore recommend that it defers consideration until a wider and more deliberate debate of the issues takes place next year. Many market players have an interest in this subject and will wish to participate fully in the review within a more realistic timescale than the Committee's call for evidence provides. It is in our view telling that when deciding whether to include extended warranties within the scope of IMD implementation, the Government chose to exclude them. We must assume that this was on the basis that the regulations referred to above were imminent, ie a deliberate decision to allow the new regulations time to bed down and for their effects to be measured. To anticipate the outcome of the two year review at this juncture would therefore in our view be inappropriate.

26. So far as we are aware, the requirements of the Supply of Extended Warranties on Domestic Electrical Goods Order 2005 (Statutory Instrument 2005 No 37) adequately serve to provide the customer with the necessary information, opportunity and time to make a genuine, transparent choice when purchasing an extended warranty. Moving regulation to the FSA would simply mean increased costs for all concerned—regulator and businesses—without any evident benefit to the consumer.

27. Through their distribution channels FLA members provide the consumer with the comprehensive information s/he needs in order to make an informed choice as to whether s/he wants an extended warranty. From the information now available from all providers, customers are able to determine what type of warranty would best suit their needs, and which providers offer the best deals. Consumers are additionally offered an extended period of 45 days to reflect on whether any electrical warranty they are being offered is really what they need and is good value, or whether an alternative provider has a better offer. Transparent sales processes and product offerings are evidenced in the very low volume of complaints received.

28. It is our view that compliance is consistent across the industry and this is reflected in a reduction of negative press coverage about warranties and selling practices. We believe that those retailers who once may have used pressure selling tactics by offering discounted warranties to close sales or altering the ratio between the product and warranty pricing, no longer have the same flexibility to do this.

29. Consumers also presently benefit from the FSA regulation of the insurers in terms of product disclosure and are afforded the safeguards of the Financial Services Compensation Scheme and the Financial Ombudsman Service.

30. We consider the costs of meeting current FSA rules for extended warranties sold through a high street distribution channel would be disproportionately high for the potential benefits to consumers. One FLA member company estimates that the initial costs of complying with the training and competence rules in their stores alone would amount to approximately £350,000.

#### THE FORM ANY PROPOSED FUTURE REGULATION MIGHT TAKE, INCLUDING MODELS FOR NON-STATUTORY REGULATION

31. Our considered views on the form of future regulation could not be assembled in the timescale available for this response. The question is a large one and requires Considerable consultation and research. However, we are of the view that self-regulation is no longer an option given the requirements of the Insurance Mediation Directive and the Distance Marketing Directive, and the regulatory position in which we currently find ourselves. However, we do have some general observations that we would like to make to the Treasury Committee.

32. In April 2006, the European Commission referred six member states to the European Court of Justice for not having implemented the Insurance Mediation Directive into their national law. The six member states were: Germany, Greece, France, Malta, Spain and Portugal. We believe that the Treasury Committee could usefully examine the insurance regulatory regimes in some other member states to determine if the UK has a heavier, or "gold-plated" approach to the implementation of the Directive than have other member states, potentially leading to a competitive disadvantage for UK businesses.

33. For example, we understand that the Finnish authorities have adopted a Principles based approach to general insurance regulation that contains no prescriptive lists, so insurers can tailor their information to the product and the customer.

34. We believe that the Financial Services Authority should be encouraged rapidly to replace over-prescriptive rules with principles; an action which we understand it has an appetite to achieve.

---

## Memorandum submitted by HolidayTravelWatch

### INTRODUCTION

This submissions provides an overview of the sale of travel insurance, either generally, or through the service of travel agents or travel providers.

HTW submits its opinions through this report, based upon the relevant consumer opinion, and its experience of The Package Travel, Package Holidays and Package Tours Regulations 1992 (PTR).

HolidayTravelWatch is British based consumers organisation founded in 1995. Through 11 years of operation, it has provided information, advice and assistance to over 130,000 holidaymakers, through its dedicated helpline and website. This should however, be put into context with the 65,000,000 individual trips taken by British Citizens in 2005<sup>1</sup>. It suggests that HTW only receives a small proportion of all complaints, however, these holiday complaints tend to reflect the more serious element of contractual, illness and injury difficulties faced by the consumer.

The Organisation currently provides information and advice, facilitating some 43.5% of all travel consumers who contact HTW, to find a resolution to their travel complaint. The remaining complainants are then given the opportunity to progress toward litigation, through travel law specialists. It is estimated that approximately 65,000 holidaymakers have received such legal assistance, and have achieved in excess of £15,000,000 in compensation for their holiday complaints, holiday illness and injuries. This report will analyse the sales of travel insurance products, and where appropriate, reference will be made to relevant legal provisions. The report will also cite the relevant experience of this organisation and the travel consumer, in support of its conclusions.

### INTRODUCTION TO THE REPORT

Since 1995, HTW has received a number of complaints, either about the sale or operation of travel Insurance. For many years, HTW has advised holidaymakers of:

1. The need to adopt personal responsibility for their actions and travel arrangements;
2. The possession of an E1-11 Health Insurance document, which has now been superseded by the European Health Insurance Card; and
3. The absolute requirement to carry appropriate travel insurance.

The purchase of any travel arrangement creates a seamless, but nonetheless complex contractual relationship, between the holidaymaker, the tour operator and their suppliers.

In traditional holiday contracts (package holidays), insurance contracts purchased from a travel agent or travel provider, import a similar complexity. That relationship will arise between the intending holidaymaker, the travel agent and/or tour operator, the insurance company and their agents.

The development of internet/e commerce based technologies has given rise to the “click n’go” generation. An internet based contractual transaction can now be completed in a matter of minutes.

Despite this relatively new method of purchasing products, we again witness the same complexity in the contractual relationship. A holidaymaker purchasing a contract of travel insurance online will establish a relationship between the holiday website owner and/or the tour operator/airline/travel agent and/or the insurance company and their agents.

That complex relationship is aided by the supply of the extensive terms and conditions that accompany travel insurance. It is suggested that whilst insurance is a very necessary part of our society, it is nonetheless, rightly or wrongly, considered by many as being dull and boring. This view stems from a product that is extensive in its legal explanations.

We must accept however, an insurance company is being asked to share in the potential risks of travel, a risk that it wants to limit through its terms and conditions.

These new consumer protections have produced slick “essential” travel insurance product information, providing the message to the consumer; it’s simple; it’s straightforward; it does exactly what it says on the flyer, or does it?

The sale of the travel insurance product is now not just confined to the travel agent. A visit to a pharmacy, the post office, banks and supermarkets will provide access to the relevant flyer or a sealed pack containing the relevant travel insurance. Web based tour operators, airlines, and insurance companies all provide a “click n’go” solution to the hungry consumer.

The shake up in the operation of the financial markets, provided the said purchasers of financial products, with clearer explanations and cooling off periods. These new consumer protections have produced slick “essential” travel insurance product information, providing the message to the consumer; it’s simple; it’s straightforward; it does exactly what it says on the flyer, or does it?

---

<sup>1</sup> Lord Treisman—FCO Reception 21.3.06.

## HOLIDAYMAKERS EXPERIENCES &amp; SOLUTIONS

HTW primarily deals with holiday complaints which concern holiday illness and/or contractual complaints. During the course of its contact with intending or returning holidaymakers, the organisation receives complaints about the sale of, or operation of travel insurance contracts. The following is a small selection of holidaymaker's problems and how we suggested that some of those problems were or could have been resolved.

*Example A:*

Mrs A travelled to France, some 7 weeks before the scheduled end of her pregnancy. She had been advised by her GP that she was fit to travel, and that she should not experience any adverse effects before her due date. She travelled by car and ferry and on arrival settled into her holiday. Halfway through the holiday, she was admitted to hospital and prematurely delivered her baby. The baby required emergency treatment in a special care baby unit. Mrs A believed that she would not encounter a problem with her travel insurance, and she was also in possession of an European Health Insurance Card (EHIC). However, she discovered that her travel insurance company refused cover, on the basis that she had travelled abroad outside the threshold period stated within her insurance. She also discovered that the EHIC only covered up to 75% of medical treatment costs in France, and it did not cover repatriation. This was not only personally distressing for this family, but it also had the potential to be financially disastrous.

HTW were not called upon to directly advise Mrs A. However, in a public statement, the organisation highlighted the need for holidaymakers to read their terms and conditions before travel. An additional issue arose over the use of an EHIC. HTW called upon the Department of Health to make a clearer statement on its promotion of the EHIC. The organisation considered that there was a need to ensure that those applying for the card were aware of the potential for a shortfall in medical costs, and that repatriation is not included.

*Example B:*

Mr B is a pensioner living in the South of England. He is a man in good health, with no substantial medical history or pre-existing conditions. He decided that he wanted to travel to Italy on a traditional package holiday. He booked the holiday through a small but established tour operator. At the time of booking, he realised that his annual travel policy had expired.

He advised the tour operator, who told him that he could not travel unless he purchased their travel insurance. He was quoted a premium of £400. Mr B knew that he was being overcharged and when he protested to the tour operator, the managing director encouraged him to go ahead stating that, "any bad news is always good news". Mr B felt that as he had bought the holiday, he had no option but to purchase the insurance.

HTW was advised by Mr B that the holiday was a disaster for him and a number of other holidaymakers. He was advised as to his rights under the Package Travel Regulations (PTR), and he chose to try and establish his own resolution with the tour operator. With regard to his insurance complaint, he was advised as to the ABTA Code of Conduct, but he indicated that he wished to pursue his insurance complaint through his membership with another consumer grouping.

*Example C:*

Mr C went on holiday to Florida with his family. Before travel he purchased travel insurance through his travel agent. During the holiday, his daughter developed a water infection requiring emergency treatment. Once the treatment was completed, he was informed that the insurance company, through which his policy was held, was "blacklisted". The apparent reason was that the insurance company had failed to pay its bills with several hospitals within the Orlando area. This dire situation required the family to immediately use its reserves of \$400, effectively ending their holiday. They attempted to contact the tour operator's representative for further assistance, but their calls were not returned. Mr C rang the insurance company in England. They confirmed that they knew of the problem in Florida but could not offer the family with any assistance.

Upon his return to the UK, Mr C discovered that the travel agency was still selling the same policy to potential holidaymakers. The agency stated that they were unaware of the problems he experienced whilst he was on holiday and could offer him no further assistance.

Mr C contacted HTW and was advised to write to the insurance company. At first they did not respond, so he was advised to contact the Financial Services Ombudsman. The response he received was less than satisfactory. He was advised that as he had been re-paid the \$400, there was nothing further they could do.

The organisation found the responses from the travel agent and the Ombudsman to be staggering. It was considered important to confront the issues raised by the travel agents/tour operator's failure to investigate a product designed to provide the holidaymaker with the ultimate protection, when something goes wrong. Equally, it was also important to confront the issues raised by the insurance company's failure to pay its

bills and provide the contracted cover. More importantly, this was an insurance company not based within the UK; there was a need to confront the ethical operation of this product. With HTW's guidance, Mr C wrote to the travel agent/tour operator; the insurance company, and the Financial Services Ombudsman to investigate and report on this serious issue. To date, HTW has not been advised as to the outcome of those further complaints.

*Example D:*

Mrs D booked and paid for a holiday with a travel agent, for her family which also included her Father. At the time of booking, she advised the agent that her father had not been well, and that this holiday was to aid his recuperation. At the time of the booking, she also purchased travel insurance. Regrettably, Mrs D's Father became too ill to travel, with the result that the family had to cancel the holiday. When Mrs D tried to resolve the problem with the travel agent, she was referred to the insurance company. The insurance company referred to their terms and conditions; she had not advised of her Father's pre-existing conditions at the time of arranging the insurance contract, therefore no cover could be provided; the family would lose their holiday cost.

HTW advised of the difficulties of pursuing the matter through litigation. Mrs C was advised of the ABTA Code of Conduct, and she was advised to write to the insurance company. In addition, she was also advised to contact the Financial Services Ombudsman to seek their advice and guidance.

*Example E:*

Mrs E booked a holiday with a travel agent for herself and her husband. At the time of booking, she advised that she had travel insurance, and therefore rejected the offer of travel insurance. At no stage did the travel agent seek to confirm the details of the insurance before confirming the booking. Unfortunately, several hours after she booked the holiday, her husband became ill, and she had to cancel the holiday with the resulting loss of the holiday cost. Mrs E protested to the travel agent and the tour operator, to no avail. The travel agent/tour operator refused to accept that they had responsibility. HTW sought to promote a sensible settlement through letter writing advice or to progress the matter through litigation. To date, HTW has not been advised as to the outcome of Mrs E's attempts to resolve the matter.

#### THE HOLIDAYTRAVELWATCH MYSTERY SHOPPING EXPERIENCE

In the course of considering the issues of purchasing travel insurance, the author of this report decided to engage in a "mystery shopping" experience. Whilst it is important to use the experience of genuine consumers, it was also considered important to understand the process by which the consumer can purchase their travel insurance. It was decided to explore the process through the attempted purchase of a travel insurance in travel shops, a supermarket, a pharmacy and through the internet. We considered it important to establish the method of selling, and how flexible travel insurance policies were. When returning holidaymakers contact HTW, it is usually because they have encountered some illness and/or contractual problem. They often discover the legal expenses insurance they purchased either prevents them from using the policy to sue the travel agent/travel provider or provides no choice on the solicitors they can choose.

#### *Tui Travel Shops*

The first visit took place on Wednesday 15 November at the New Street Birmingham Branch. Unfortunately, no representative was available. An examination of the shelves and public areas, found that there was no information on travel insurance, only brochures were available.

The second visit took place on the same day at their Bull Ring Birmingham branch. A request was made for a travel brochure, followed by information on travel insurance. We were advised that no holiday would be sold without a relevant travel insurance policy being in place. We were advised that they could provide travel insurance, and that it would be added to the final bill. No insurance brochure was available. However, the assistant did print off a summary of the insurance "benefits". The summary provided basic details, but no information on exclusions; it was not possible to establish the nature of the limits to any travel insurance policy or its exclusions. No terms and conditions were available; these would be given at the time of purchase. When questioned about whether 'external' insurances would be acceptable, we were advised that at the time of booking details of the insurance company and the policy number would have to be provided before the holiday booking could be confirmed. The Thomson Holiday Brochure confirmed this information, it states;

*"All party members, including infants and children, must be adequately insured on holiday, and this is a condition of booking with us. You may either: accept our recommended policy, in which case the premium will be added to your holiday invoice; or choose a policy at least as good with another company. If you choose a different company, you must tell us so that the insurance company details and policy number can be recorded by us. We must have this information before we can confirm your*

*booking. Details of our recommended policy are available upon booking. Adequate insurance is important in case your holiday is affected before or after departure by illness and other events beyond our control as we do not pay compensation for these”.*<sup>2</sup>

THOMAS COOK

The Bull Ring Branch in Birmingham was visited on Wednesday 15 November 2006. An examination of the store could not establish any available detail on travel insurance. We managed to speak with an assistant who initially had difficulty in finding information on travel insurance. She spoke with a colleague who found some brochures at the bottom of a cupboard. The assistant provided us with that insurance brochure. We discovered that where a personal injury had occurred, benefits were limited to death or permanent disability. It did not include injury through food poisoning or water borne diseases. There was a general exclusion to benefit for any pregnancy related issue beyond 8 weeks.

With regard to legal expenses, the holidaymaker was excluded from using this benefit for;

*“Claims against a carrier or the travel or holiday agent or tour operator arranging an overseas journey covered by this insurance or AXA Insurance, AXA Assistance or their agents*

*Claims where in our opinion there are no reasonable prospects for success.”*<sup>3</sup>

Within the Thomas Cook Brochure there is a summary of the potential cover that can be provided, warning the reader of the need to provide details of pre-existing conditions. Within the same brochure, there is a section marked “Before You Travel”, it states;

*“You must take out Holiday Insurance suitable for your needs before you travel. We cannot be responsible for any costs you incur as a result of failing to do so. For your own peace of mind the insurance should cover you if you have to cancel your arrangements, or for any emergencies that arise while you are away. We recommend the insurance we offer (see page 538) as it provides cover, which meets most people’s needs. Please check your policy when you receive it and take it with you on Holiday”.*<sup>4</sup>

When we were provided with the insurance document and brochure, we were not advised about our own insurance, or whether it was a formal requirement of the booking.

We then turned our attention to Boots The Chemist, High Street, Birmingham. We visited the store on Wednesday 15 November 2006. It took several attempts to establish the location of travel insurance information. We were directed to several flyer leaflets, one dealing with multi-trip policies, the other for city breaks. The first brochure briefly described the benefits and cost. It contained no information on exclusions or duties of pre-disclosure. The city breaks brochure contained some information on exclusions in medical cover (these being principally pre-existing conditions). There are references to policy wording and helpline numbers to aid in the completion of the application form. Within that document, there is reference to regulation by the Financial Services Authority and that they are covered by the Financial Services Compensation Screen. When requested, we were advised that the full policy document would be made available on purchase; it was not available prior to purchase.

On 16 November 2006 we sought to purchase travel insurance from the supermarket store, Tesco, Hall Green, Birmingham. On display were sealed packets containing “ready made” policies for different travel requirements. Examination of those packets did not reveal the nature or summary of cover. We requested that information from the customer service desk within the store. Two assistants sought to provide a summary fact sheet but could not find any. They stated that the only way to determine the nature of the cover was to buy the product and if it was not satisfactory, to return it to them for a refund. The alternative was to visit their website where it was thought that the summary and terms & conditions could be located.

Our next shopping experience came from three internet providers:

1. www.insureandgo.com was examined on 19 November 2006. The web portal was quite simple to negotiate and within minutes, we had chosen a “Silver” single policy for travel in Europe in December 2006 for £9.26p. A simple summary of the cover was available, but it took several minutes for us to determine that the full terms and conditions were available on the top toolbar. We discovered the terms and conditions amounted to 24 pages of script. Similar exclusions for medical claims were found in this policy that were found in earlier “shopping” discoveries. The legal expense facility included the exclusion as to use if they considered that the claim would not be successful, and that no claim could be entertained against them, their agents, their representatives, a tour operator, a provider of accommodation or against anyone who arranges travel.<sup>5</sup>
2. www.easyjet.com was examined on 19 November 2006. The web portal directed the “shopper” to a separate page—www.easyjet4insurance.com—and a search for appropriate insurance was carried out. We sought insurance for a 10 day trip to Turkey in July 2007. We were provided

<sup>2</sup> Thomson Destinations Summer Collection—April to October 2007 2nd Edition (P.541).

<sup>3</sup> Enjoy your holiday with our travel insurance—6th Edition (P. 31).

<sup>4</sup> Thomas Cook Summersun—2nd Edition—April to October 2007.

<sup>5</sup> www.insureandgo.com—19 November 2006.

with a quote and a summary of cover. Again we encountered some difficulty in establishing the full terms and conditions, but found those under the “Product Information” section. We discovered that we had changed sites again. We were now met with a message at the bottom of the page which stated, “Welcome to Mondial Assistance Group E Commerce Website Authorised by the Financial Services Authority”. Within the product information, we established the extent of cover and exclusions. Before we could purchase the insurance we had to “sign” an online warranty dealing with pre-existing conditions, these conditions were extensive and would need careful consideration by any consumer. Further exclusions contained a limit on legal expenses whereby the policy could not be used to sue the tour operator, travel agent, a carrier or easyjet. Where there was a claim for physical injury, no payment could be made to someone who was under 15 years of age and had suffered a permanent physical injury. Where an motor cycle injury was claimed, this would not be entertained if the injured party had not worn a crash helmet. No claim could be made where there was a failure by the tour operator or airline to provide transport in the event of a cancellation. In pregnancy claims, no such claim would be entertained if the pregnancy was beyond 24 weeks outside Europe and 28 weeks within Europe.<sup>6</sup>

3. www.ryanair.com was examined on 19 November 2006. Again we sought a quote for European travel in December 2006. We were provided with the option of cover with a Ryanair flight, or cover with another airline’s flight. We chose Gold Cover and Scheduled Airline Failure Cover for £12.25p. Within the viewing window there was a “cover details” summary button. This provided a brief summary of the available cover for the premium. After searching, we discovered that the policy documentation was contained in a menu on the left hand side. When we opened this facility, we discovered an array of .pdf documentation. We chose the gold cover information. Under legal expenses, the exclusion revealed that the policy could not be used to sue Ryanair, the Underwriters of the policy or the Insurance Company. Medical exclusions again mirrored previous policies examined, but we found that this policy excluded the costs of private medical treatments, and claims had to be notified within 14 days. When we examined the Scheduled Airline Failure Cover we discovered that claims could not be made in “force majeure” situations or where other policies existed. We then chose a policy without a Ryanair flight and received a quote for £25. This however did not include the Scheduled Airline Failure cover, which was not available.<sup>7</sup>

It was clear from our “shopping experience”, that the consumer is faced with a bewildering amount of information and some difficulty in accessing that information. What is of greater concern is the manner in which these policies are sold and the exclusions that are attracted by such policies. It is likely that many people do not read the terms and conditions, or find accessing them difficult. We would suggest that the average consumer would need to be quite determined to cross-check policies and exclusions before being in a position to make an informed choice.

#### DEVELOPMENTS WITHIN THE PACKAGE TRAVEL, PACKAGE HOLIDAYS AND PACKAGE TOURS REGULATIONS 1992 (PTR)

It is not only important, but also relevant to place the issue of travel insurance within the context of other consumer protections.

The Campaign by HolidayTravelWatch, highlighting the threat to the rights currently enjoyed by many thousands of British Package Holidaymakers, suffered a blow when the Court of Appeal supported the case brought by the Association of British Travel Agents (ABTA) against the Civil Aviation Authority (CAA).

The case arose when the CAA issued guidance which required travel agents to obtain an Air Tour Operators Licence (ATOL), whenever they created or sold a Package Holiday.

ABTA sought to challenge the decision making process of the CAA through Judicial Review. They contended that the guidance and requirements on the travel agents were flawed, and that the decision of the CAA should be overturned.

The importance of this bond cannot be underestimated. The ATOL Licence must be taken out by an organiser who sells an air package holiday. This Bond protects the holidaymaker whenever a holiday company goes bust. It provides a lifeline to a holidaymaker and for that matter the supplier, who is stranded as a result of the failure.

The cover allows for the continuation of the holiday, or the return of the holidaymaker back to their home airport. Many ask us, why is this case important? If it only affects travel agents, how can that affect the holidaymaker who buys his holiday from a tour operator?

<sup>6</sup> www.easyjet.com—19 November 2006.

<sup>7</sup> www.ryanair.com—19 November 2006.

The guidance was issued by the CAA, because an imbalance was being created within the travel market in the way holidays are being sold. The advance of internet and broadband technologies has seen a rapid demand for the services provided by the low cost budget airlines. The speed of this growth has cut to the very heart of the Travel Industry, and in its wake follows the travel consumer.

The importance of this case is not just about whether a travel agent needs an ATOL Licence; it was also about the definition of a Package Holiday. The question asked was, how could a travel agent be held to be creating a Package Holiday, when conversely a budget airline does exactly the same thing through their website, but they do not require bonding?

It exposed the lack of courage by the Travel Industry and successive Government's, in not challenging the airline industry's untouchable monopoly. We know from the earlier court decision, that the lower court held that the definition of a Package Holiday, contained in the Package Travel Regulations (PTR), was somewhat redundant, out of date. The court was not tasked with redefining the Package Travel Regulations, merely to understand how the CAA made their decision and whether that process was flawed.

The Court of Appeal was attracted to the argument made by ABTA, that in the purchase of an online holiday product, it was akin to purchasing the week's shopping, and therefore not one product, but many. As a result there could be no package. However, the Travel Industry did not have it all its own way. The Court of Appeal raised the real possibility of uncertainty, effectively asking, when is a package not a package—when it is a question of fact!

The full copy of the Court of Appeal judgement can be viewed at this link—  
<http://www.abtamembers.org/download/finaljudgement.pdf>

However, if the industry follows the new generation companies and budget airlines, the fear is that they will also follow the court's comments on what constitutes a package.

In an article in the *Travel Trade Gazette* (21/7/06), David Moesli director of the CAA's consumer protection group stated,

*"I think the Wild West, if it is not here, is on the way—and the cavalry is not coming".<sup>8</sup>*

The state of the package holiday was addressed by travel journalist Jeremy Skidmore in the *Western Mail* (20/9/06), he stated,

*"It's no exaggeration to say that the travel industry is unravelling before our eyes. The package holiday, once a desirable goal, is now something that millions of people are turning their backs on".<sup>9</sup>*

In *TravelMole* (20/10/06), Peter Rothwell from TUI said,

*"We have been nervous about selling flights and accommodation together, because of being liable if something goes wrong . . . on dynamic packages, we would no longer be liable, for example, for the behaviour of Pedro the waiter or a dodgy car hire fire in resort".<sup>10</sup>*

The purpose of this section is to demonstrate the real threat to the travel consumer, from an unregulated and unprotected travel market. If that threat materialises, we suggest that it will unleash a holiday misery not seen since prior to the inception of the Package Travel Regulations in 1992. Amongst those potential problems, lay the thorny issue of a travel industry selling holiday insurances that may not be appropriate to consumer needs or protection.

#### PROBLEMS AND SOLUTIONS WITH TRAVEL INSURANCE

In determining the issue of travel insurance and the travel industry, a number of important considerations arise.

##### *The ABTA Position:*

The position of travel agents/tour operators and travel insurance is governed by the ABTA Code of Conduct. Rule 1.7 is summarised thus:

- Members shall draw the client's attention to the availability of "insurance cover to suit their client's requirements";
- Where a policy is issued, it "shall be appropriate for the client's requirements";
- "Members shall ensure that client's are aware of the need to comply with the insurance company's requirements and of their duty to disclose to the insurance all relevant information, eg pre-existing illness";
- Members have to "strictly comply" with an insurance company's terms of business and make prompt provision of financial returns;
- Insurance which is not arranged by the Principal must be provided within 48 hours;

<sup>8</sup> *Travel Trade Gazette*—21 July 2006.

<sup>9</sup> *Western Mail*—20 September 2006.

<sup>10</sup> *TravelMole*—20 October 2006.

- 
- The remainder of the Code deals with the identification of cover, the suitability of any other insurance not supplied by the Member, and any policies sold are appropriate to the holidays sold.<sup>11</sup>

We have already discovered, through the holidaymaker's experiences in this report, the perilous state of cover, understanding or operation of travel insurance. It is clear that the majority of holidays do not require the activation of the travel insurance policy, and therefore there will be the argument that the sale of insurance policies works, that it does not require regulation. However, it is also clear from the case studies produced, that there is an element of the travel industry that does not comply with the rule as stated above.

In light of the scenarios produced, we must ask, what steps does ABTA or the Insurance Industry take to monitor the sale of travel insurance?

How many travel agents or tour operators have been disciplined under the said Code of Conduct for breaching its professional obligations?

How many travel agents/tour operators have been reported by the insurance industry to the Regulator or ABTA for any failures determined?

How many holidaymakers have been compensated under the Financial Services Compensation Scheme?

Is it right that some parts of the travel insurance industry clearly state their Regulatory responsibilities under the Financial Services Authority, whereas the bulk of the travel industry is not required to be so regulated?

What real protection is afforded to the consumer by the "unregulated" part of the industry?

Is it time to provide a safety net "premium" for those holidaymaker's caught either through ignorance, or mistake, as identified in the cases of Mrs A & Mrs E above?

"It is time to import a greater corporate ethic into complex consumer contracts, the age of the '*laissez-faire*' approach to consumer relations, must surely be past its sell by date?"

Is the complaint's process of ABTA or the Regulator rigorous enough, or consumer focussed to deal with the similar problems as identified in the cases of Mr B & Mr C above?

Does the sale of a complex financial consumer contract, now require the additional protection of regulation, in a real and growing unregulated market?

We consider that these questions now form the basis of a long overdue enquiry, for the benefit of the ordinary consumer, against an industry which has vast resources. This same industry will argue that Regulation will make them uncompetitive and unattractive. We disagree. We consider that the failures to address the problems identified by the case studies above, is more widespread than we know. It is time to import a greater corporate ethic into complex consumer contracts, the age of the '*laissez-faire*' approach to consumer relations, must surely be past its sell by date?

### *Is the Consumer Really Protected?*

The theme from our "shopping experience" confirms a long held view of this organisation, the view that contracts of holiday insurance do not support the real protection of the holidaymaker.

The principal concern is the operation of the legal expenses clause. Can it be right, that a consumer, who enjoys the protections of the PTR, is then prevented from using that insurance policy to pursue legal action against the travel provider?

Indeed, what does that say about the relationship between the insurance industry and those travel providers?

"Is it time for the Office of Fair Trading (OFT) to investigate these issues?"

If the product sold is a safe product, following all the established practices and principles to protect the consumer, then why should a consumer be prevented from challenging the service provided through want of funds?

Additional issues arise as to choice of a legal advisor. Many holidaymakers discover that they cannot use a recommended solicitor; they are required to use the in house solicitor of the insurance company. It raises the question, what experience does the insurance company have in assessing or handling travel claims?

The legal expense clause exclusion suggests an incestuous relationship between the travel industry and the insurance market, it raises further questions:

- Where is the consumer choice?
  - Does this not suggest the operation of a cartel?
  - Is it time for the Office of Fair Trading (OFT) to investigate these issues?
- 

<sup>11</sup> *Holiday Law*—3rd Edition—Grant & Mason (Pgs—563 & 564).

The examination of insurance contracts, through our “shopping experience”, reveals a fairly standard approach by the insurance industry, in drafting their term & conditions. If the conditions are generally standard, then why can the consumer not expect a standard travel insurance contract? Surely this would import more certainty into travel insurance contracts, and raise consumer awareness as to the type of product they would be buying? Arguments will be raised that this cuts into a company’s competitive edge. We are not convinced. There are already moves to standardise the operations of the courts in the UK, harmonise laws within the EU, why not the terms & conditions of a contract of insurance?

#### CONCLUSION

The review by this Organisation into the issue of the sale of travel insurance in holiday contracts has been long overdue. We do not represent this to be a full or accurate enquiry. Because of the difficulty of accessing information, the likelihood exists that as an “interested ordinary consumer” we may have missed essential points. We suggest this potential fallibility represents the real world of the travel consumer.

We consider that the consumer is the weaker element in such sales and contracts. Who speaks for the consumer, who protects his or her rights? What steps are necessary to promote a confident bargain between the consumer and the vastly resourceful travel and insurance industries?

We suggest that there is sufficient concern to raise the possibility of a general public enquiry, or at the very least, an enquiry by the OFT into the matters raised by this report.

Without such enquiry, we fear a scandal regarding the mis-selling of such policies will arise, the loser ultimately being the consumer.

*November 2006*

---

### **Supplementary memorandum submitted by HolidayTravelWatch**

#### INTRODUCTION TO HOLIDAYTRAVELWATCH

Following the written and oral evidence supplied by this organisation to the, House of Commons Treasury Select Committee on Thursday 23 November 2006, the organisation has been invited to provide supplementary evidence dealing with any residual issues raised within that hearing.

HolidayTravelWatch (HTW) submits its opinions through this report, based upon the relevant consumer opinion, and its experience of The Package Travel, Package Holidays and Package Tours Regulations 1992 (PTR).

HolidayTravelWatch is British based consumers organisation founded in 1995. Through 11 years of operation, it has provided information, advice and assistance to over 130,000 holidaymakers, through its dedicated helpline and website. This should however, be put into context with the 65,000,000 individual trips taken by British Citizens in 2005.<sup>1</sup> It suggests that HTW only receives a small proportion of all complaints, however, these holiday complaints tend to reflect the more serious element of contractual, illness and injury difficulties faced by the consumer.

The Organisation currently provides information and advice, facilitating some 43.5% of all travel consumers who contact HTW, to find a resolution to their travel complaint. The remaining complainants are then given the opportunity to progress toward litigation, through travel law specialists. It is estimated that approximately 65,000 holidaymakers have received such legal assistance, and have achieved in excess of £15,000,000 in compensation for their holiday complaints, holiday illness and injuries. This report will analyse the sales of travel insurance products, and where appropriate, reference will be made to relevant legal provisions. The report will also cite the relevant experience of this organisation and the travel consumer, in support of its conclusions.

#### ORAL EVIDENCE:

During the course of oral evidence given by Frank Brehany, a statement was made (found at question 4), identifying Thomas Cook as the tour operator supplying travel insurance, whereby those aged under 15 years suffering from a permanent physical injury, would not be entitled to receive an injury payout. The tour operator identified was incorrect; the correct vendor of the travel insurance was in fact Easyjet. This information had already been confirmed in the report submitted to the Select Committee by HolidayTravelWatch, at pages 13 and 14.

---

<sup>1</sup> Lord Treisman—FCO Reception March 2006.

Apologies have been provided to the Select Committee, and are also extended to Thomas Cook, for what will be recognized by all as a genuine error. No disrespect was intended to any party. The remainder of the Select Committee transcript has been checked, and so far as HTW is concerned, no further issues arise therein.

The error does however highlight an important issue. As the travel consumer, and in particular, families, decide to take a greater responsibility for making their own travel arrangements, the failure to recognize, or indeed to be warned of the limitations in such a policy, could have catastrophic results for such a family.

It is the intention of this supplementary report, to highlight the range and limitations of various travel insurance products, upon the travel consumer and on the family highlighted in the evidence of Frank Brehany.

#### STANDARD CONTRACTS FOR TRAVEL INSURANCE

During the course of his evidence, Frank Brehany highlighted the range and scope of documentation supplied to holidaymakers. He suggested that it may be appropriate to introduce a uniform contract or standard wording for the travel insurance product.

In reviewing the report from HTW, and the evidence of Frank Brehany, it seems logical therefore, that if holidaymakers are to avoid confusion or lack of understanding, in so far as the purchase of travel insurance is concerned, then the promotion of a standard worded document would seem to be a fair proposal.

In the course of his evidence, David Monks from the Association of British Travel agents (ABTA) considered this proposal to be “somewhat bizarre” (question 65).

HTW considered that its proposal to promote a standard form contract is in fact in line with many issues that we take for granted. For example, when we purchase a house in the United Kingdom, a standard form contract is utilised by both the vendor and purchaser of the property. This standard form of contract provides certainty for both parties, and provides for a uniform method of handling the transaction by either the conveyancer or solicitor.

It can also be seen that a standard form of information is required where a consumer is involved in the purchase of a product through distance selling. The Consumer Protection (Distance Selling) Regulation SI 2000/2334 implemented the Directive dealing with Internet sales. There are a number of exemptions concerning Internet sales, but it is clear that Regulation 7 provides for a standard form of contract, which provides important consumer information as to the type of goods that they are purchasing, the means and method of delivery, issues of payment, and matters concerning their consumer rights. In fact the regulations go further, in that they state the following:

*“The supplier shall ensure that the information required by paragraph (1) is provided in a clear and comprehensible manner appropriate to the means of distance communication used, with due regard in particular to the principles of good faith in commercial transactions and the principles governing the protection of those who are unable to give their consent . . . ”*<sup>2</sup>

Another example of a standard contract can be found in the model provided by the Association of British Travel Agents. They suggest that travel agents and tour operators can utilise their own model booking conditions, as a means of creating a contract with a holidaymaker wishing to purchase a package holiday. In fact, most tour operators have employed those very model conditions suggested by ABTA, and in fact the travel industry closely monitors each other’s conditions, adapting their own to meet with their competition<sup>3</sup>.

We ask the question; what is “bizarre” about the suggestion of a standard form contract?

It is clear that there are now many walks of life that seek standardisation, and it was our oral presentation that presented the move is towards greater harmonisation of practices and laws.

There are those in industry or business commentators that suggest that anything that impedes the flow of contractual relations is somehow uncompetitive. Can this really be true? Are those involved in the sales/purchase of property, or those involved in Internet sales, or for that matter those involved in the sales of package holidays to holidaymakers, experiencing a reduction in their ability to trade simply because of a standard form contract?

In the oral presentations to the Select Committee, ABTA rejected the view that travel insurance contracts should be somehow standardised, implying that it would make the travel insurance product less attractive to the consumer, is this not somewhat at odds with the general practice. We would certainly encourage both the Select Committee and the Treasury Department to consider the standardisation of travel insurance contracts, as an appropriate and relatively inexpensive means or method to assist at the travel consumer to understand, what is after all, a complex product.

<sup>2</sup> The Sale of Goods 11th Edition—Atiyah, Adams & McQueen—Pgs 58 & 59.

<sup>3</sup> *Holiday Law* 3rd Edition—Grant & Mason—Appendix Three, Pgs 578 to 593.

---

 NATURAL OR MAN MADE DISASTERS

This organisation has written openly and extensively on the issue of “force majeure” situations, experienced by growing number of holidaymakers.

In our view, there is a difference between what we call a genuine “force majeure” situation, and a “force majeure” situation “with notice”. The example of a true “force majeure” situation would be the unexpected arrival of a Tsunami or Tornado. The example of a force majeure situation “with notice”, would be the arrival of a hurricane tracked by satellite, or a series of reasonably expected terrorist attacks in an area with heightened tension and activity.

We remain concerned that tour operators or travel companies provide holiday contracts, or travel arrangements to what we describe as “at risk” destinations.

For holidaymakers who are either trapped or are introduced into such a risk area, their first port of call is not for the terms and conditions of their travel insurance, but rather the assistance of their travel provider. We consider that in the context of the present debate, it is necessary to illustrate the position of the travel consumer, both from a consumer protection standpoint and from the position of travel insurance.

The effect of the 2004 Tsunami and the Bali bombings brought great criticism upon the Government, in what was seen as their failure to provide assistance to Britons abroad. As a result of this criticism, the Foreign & Commonwealth Office revamped and extended its Consular Assistance service for British holidaymakers or travellers.

It is important to highlight this fact, as we consider that it directly relates to issue on the holidaymaker’s ability to keep themselves safe, and perhaps how industry are benefiting from a contractual “loophole”.

It can be seen from the earlier report from HTW, the growing threat to the traditional package holiday, following the recent decision in the Court of Appeal against the Civil Aviation Authority.

We have already seen tour companies downsizing their support staff in holiday resorts since the 2005 holiday season. In their place they have provided either contact numbers or helplines, based in the United Kingdom. It is not appropriate to widen the discussion on these issues within the confines of this report, but it is clear that the ever-increasing demand for Consular Services, demonstrates the real need for assistance, particularly where a situation arises which poses a real threat to life and property. We suggest that the increased assistance provided by the Foreign & Commonwealth Office, is leading the British Taxpayer toward becoming the guarantor for British holidaymakers, who find themselves exposed to an extreme event. Is this a failure of consumer regulation or a failure of insurance?

It is the experience of HolidayTravelWatch, that holidaymakers finding themselves in this situation, very rarely find true assistance from their tour companies, many are not repatriated back to the United Kingdom in the aftermath of an extreme event. They are often “required” to complete their holidays in extreme conditions; some holidaymakers find that they are flown into at an “at risk” area, with tour companies often hiding behind their own “force majeure” clauses.

The “force majeure” argument imposed upon holidaymakers, provides a further burden on the holidaymaker; the burden of responsibility.

To understand that burden we consider that it is necessary to re-produce a section of our earlier report, commenting on the future development of the Package Travel Regulations.

By doing so, we can demonstrate clearly how a holidaymaker is exposed to a lack of protection and assistance when faced with a so called ‘force majeure’ event. To begin this examination, we summarise the three principal protections under the Package Travel Regulations:

*Regulation 12—Significant Alterations to Essential Terms*

*Regulation 13—Withdrawal by a Consumer*

*Regulation 14—Significant Proportion of Services not Provided.*

We have grouped these Regulations together, as they have revealed an area of difficulty experienced by many holidaymakers.

The two main areas of difficulty concern the change to holidays on arrival at the destination or where holidaymakers have been exposed to natural or man made disasters.

A holidaymaker and his family arrived in Mexico on 13 July 2005 just ahead of Hurricane Emily. The first time they were informed of the hurricane’s imminent approach was at the welcome meeting, hosted by the tour operator’s representative on 14 July 2005. Despite questions posed by the holidaymakers, the representative did not have information and persisted with the sale of excursions. This holidaymaker noted however the preparations being made by the hotel, and persisted with questions to the representative. He was eventually informed that they would be evacuated to a refuge centre and to “chill out” and take photographs of the beach! He was then later advised that representatives from the Federation of Tour Operators (FTO) would be on hand to assist them through the hurricane period, and that they would be allowed one fax back to the UK. The day before the hurricane arrived, a large number of guests arrived on a flight from Scotland. At this stage there were neither representatives available nor any representation from the FTO. They were placed into barricaded blocks, six to a room. The holidaymakers became concerned when they heard through CNN that there was serious flooding some 6 miles inland. When the hurricane

arrived, they were told by hotel staff to huddle into bathrooms for safety. They experienced flooding and damage to the block they had been placed into, and following the hurricane, they discovered that there was much devastation, no power and only very limited food and milk. As there was still no representation available to assist them, the holidaymakers set about a task of organising themselves within their flooded and damaged accommodation.

This holidaymaker and his family endured several days thereafter of false starts and moves to different hotels before finally being evacuated back to the UK. In his letter to the tour operator he stated, "It is my belief you had ample opportunity to plan for this event and as opposed to flying out 360 people on the Saturday, you should have flown out extra staff"<sup>4</sup>

"but what I feel could have been prevented by you, by not evacuating us earlier and putting my family and myself through the most terrifying ordeal was quite shameless and totally irresponsible"

Another family were caught up in Hurricane Wilma. On the second day of their holiday they were informed by the representative that the holiday resort was to be hit by a hurricane. For 60 hours they were confined to their bedrooms with only two bottles of water between them. When the hurricane passed, they too experienced devastation, no power, no running water, flooded rooms, food rationing and large number of people all looking for assistance. In his letter to the tour operator, he stated, "but what I feel could have been prevented by you, by not evacuating us earlier and putting my family and myself through the most terrifying ordeal was quite shameless and totally irresponsible".<sup>5</sup>

On the days the bombs were detonated in Sharm El Sheik in 2005, one family were busy preparing for departure the next day. Having seen the news reports they contacted the tour operator, aware that their hotel was in the vicinity of the blast. The tour operator advised them that there were no problems within the resort, and that they would be able to take their holiday as normal. They were advised that the danger from bombs had now passed, and the terrorists would be unlikely to return. The news reports provided grim viewing, and the family persisted with their questions with the tour operator. Still the same response from the tour operator, and when the family suggested a change in resort, they were advised that there were no holidays available and any cancellation would attract a total loss of the holiday cost. The next day the family continued to try and reason with the tour operator all to no avail. At the UK airport, the tour operator maintained their position, the resort was safe, and cancellation would mean the loss of the holiday cost. The family were so upset and frightened, half decided to go, and the other half remained behind and lost their holiday. When the family arrived at the hotel they found that many windows were blown out, utilities were not working correctly, they experienced a heightened security situation in all this was not the holiday they booked. The family then became ill and frightened, and demanded that they be returned to the UK, this was eventually achieved several days later. The family sought medical assistance when they returned to the UK and discovered that they were ill with a notifiable disease called Giardia. They unwittingly passed this disease onto the family members who had decided not to take the holiday.<sup>6</sup>

One holidaymaker and his family went to Mexico in October 2005 and were caught up in Hurricane Wilma. They only experienced the first day of their holiday without interruption; the rest of the holiday was either taken up with sheltering from the hurricane for 62 hours or enduring the aftermath which included wet beds, no power, no assistance and a journey home that took 26 hours. When they wrote complaining to the tour operator, they were offered £346 pp in compensation for a holiday that cost £865 pp<sup>7</sup>.

These examples are not new. One client and her family were flown into the aftermath of Hurricane Georges in Cuba. They were not given the option to cancel their holiday, despite the fact that it was clear that the hurricane was advancing toward their resort. They travelled to the resort assured that everything was in order; once there they experienced the full force of the hurricane, they suffered illnesses and robbery was committed against them and other holidaymakers.<sup>8</sup>

The experiences of those caught up with Hurricane Ivan, witnessed holidaymakers pleading with tour operators to watch the reports on CNN and the FCO about the approaching Hurricane before they departed. The tour operator advised that there would be no problem with the hurricane on their holiday. They were flown into the resort, which had already become affected by the preceding bad weather. For several hours, the holidaymaker's only shelter was an open sided covered bus stop outside the terminal building. When they were "rescued", they were shipped to different hotels and suffered lack of power and basic facilities. On their return home, many of their complaints fell on deaf ears; many did not achieve any form of compensation.

It was claimed by the tour operator in many of these cases that it was an "Act of God" that had affected the holiday. They claimed that they had placed warnings in their brochures to advise potential holidaymakers of strong weather conditions. In an examination of many brochures offering holidays to these destinations, it can be seen that weather warnings are placed in their brochures. The question however, is why they are not placed within a contractual document with more prominence and emphasis?

<sup>4</sup> HTW—3369.

<sup>5</sup> HTW—3599.

<sup>6</sup> HTW—Sharm.

<sup>7</sup> HTW—3504.

<sup>8</sup> HTW—113.

We would submit that many of these severe climatic events are not random unpredictable “Acts of God” they are in fact “Acts of God—With Notice”<sup>9</sup>.

The “Act of God” argument is used to highlight that unpredictable events cannot be foreseen or planned for, therefore no rights accrue. The advances in predictive technology however, throw light into the shadow where tour operators currently hide. This is the area where they maintain nothing can be assessed or predicted—this is an excuse for failing to provide a proper response to an implied and obvious duty of care in Holiday Contracts.

In recognition of the failure of these Consumer Protections, it seems the holidaymaker must look elsewhere for his protection.

Following the Court of Appeal decision, there is now pressure on a holidaymaker to not only agree to a £1 levy to protect themselves against an insolvent holiday company, but it is widely suggested that the holidaymaker seeks a much wider protection against all events through the purchase of insurance. Is such protection possible through insurance?

There is now a growing recognition amongst holidaymakers that the so-called cheap holiday, is in fact bolstered by additional charges and liabilities following their exposure to an extreme event.

Even with the benefit of travel insurance, how protected is the average holidaymaker if they become stranded, suffer damage, made ill, or injured as a result of that extreme event?

The answer can be found in an examination of the policies found and described in the first report of HTW to the Select Committee.

To illustrate the issue, let us assume that our holidaymaker has suffered a double calamity, in that he has been exposed to terrorist incidents which have caused damage to his personal property, and he has been further exposed to injury.

Now let us examine the table below to see what “benefits” he would receive from various policies:

<i>Name of Insurance Company/Tour Operator</i>	<i>Potential Property Damage Benefit</i>	<i>Potential Injury Benefit</i>	<i>General Exclusions and Exclusions for Force Majeure Event</i>
Thomas Cook/AXA Insurance Plc <sup>10</sup>	Up to £1,600, Valuables limit £400 in all, single article limit £325, delayed luggage up to £250, Passport up to £500	Death £15,000, Permanent disablement £30,000, Under 16—death £2,000  Medical Expenses of up to £10,000,000, Funeral Expenses abroad £2,500, Continuation of Treatment £250	Pregnancy within 8 weeks from the start or the end of the trip.  Losses will not be paid for Medical Expenses and Personal Accident where there is—War, invasion, acts of terrorism, foreign enemies, hostilities or warlike operations, civil war, rebellion, revolution . . . civil commotion assuming the proportions or amounting to an uprising . . . any persons or group of persons . . . committed for political religious, ideological or similar purposes including the intention to influence any government and/or to put the public . . . in fear. Such expenses will be paid where there is a nuclear, chemical or biological attack or where disturbances are already taking place at the beginning of a trip.  Legal expenses . . . cannot be used where there are no reasonable prospects for success . . . claims against a carrier or the travel or holiday agent or tour operator.
Ryanair <sup>11</sup>	Personal Effects, Baggage, Travel Documents, Delayed Baggage up to £1000. Single item £250, Valuables £250, Travel documents £250, Delayed baggage £150	Personal Accident Max £15,000, Loss of Limbs/sight under 70 £15,000, Permanent total disablement £15,000, Death benefit (18-70) £5,000, Death benefit (under 18) £2,500, All benefits over 71 £2,500	Within the Ryanair policy there is a very extensive exclusion for terrorist acts. Much of the wording is similar to the Thomas Cook Policy; however, it excludes damage to property caused by ionising radiation. No claims will be paid for injury as a result of this extensive clause. It is also clear that medical treatment would become

<sup>9</sup> HTW—Press Release—2005.

<sup>10</sup> Thomas Cook—Travel Insurance Sixth Edition.

<sup>11</sup> Ryanair—Travel Insurance (10.12.06).

<i>Name of Insurance Company/Tour Operator</i>	<i>Potential Property Damage Benefit</i>	<i>Potential Injury Benefit</i>	<i>General Exclusions and Exclusions for Force Majeure Event</i>
		Medical Treatment up to £5,000,000	payable under the European Health Insurance Card, not the policy of insurance.  Legal expense insurance is not available for claims against Ryanair, the insurer or for use in group actions.
Easyjet <sup>12</sup>	Personal possessions (optional) You are covered for up to £1,750 if your personal possessions are damaged lost or stolen on your journey. £200 is the most you can claim for a single article. £300 is the total amount that you can claim for all your valuables. A deduction may be made for wear, tear and loss of value.	<p>“Medical emergency, repatriation &amp; associated expenses We will pay up to £10 million if you are taken into hospital or you need to come home early or extend your journey because of illness or accident”</p> <p>Personal accident We will pay up to £15,000 if, following an accident, your injuries lead to death or permanent disability. An accident must be caused by something external and visible.</p>	<p>Cover is not provided for Medical Expenses: —Medical conditions that you knew about before travelling, unless you told us about the medical condition and we offered cover for it —Travelling on a motorcycle over 125cc unless the rider has a valid driving licence — Pregnancy or birth where the due date is less than 8 weeks after your return — Medical expenses in the UK</p> <p>Cover is not provided for Personal Possessions: —Any claim not supported by a police report —Any items left unattended unless they are locked in your accommodation or the luggage compartment of a motor vehicle — Anything which you cannot provide a receipt or proof of ownership for — Valuables carried in suitcases or left in a motor vehicle —Damaged items if you do not keep the items for repair or inspection</p> <p>Cover is not provided for Personal Accident: —Anything caused by an illness —Suicide —Any more than £1,000 for death if you are 15 and under or 71 and over at the time of the accident —Any claim for permanent physical disability if you are 15 and under or 71 and over at the time of the accident</p> <p>Cover is not provided for Legal Expenses: —Defending you if legal action is taken against you —Any costs not agreed by us —Any claim against a travel agent, tour operator or carrier, or us —any claim not notified to us within 90 days</p> <p>We will not cover you for any claim arising from, or consisting of, the following:</p> <ol style="list-style-type: none"> <li>1 A relevant fact that you knew about before you travelled, unless we agreed to it in writing.</li> <li>2 War, invasion, act of foreign enemy, hostilities (whether war is declared or not) civil war, civil commotion, rebellion, revolution, insurrection, military force, coup d’etat, terrorism, weapons of mass destruction.</li> <li>3 Any epidemic or pandemic.</li> <li>4 You not following any suggestions or recommendations made by any government or other official authority including the Foreign and Commonwealth Office during the period of insurance.</li> <li>5 Your property being held, taken, destroyed or damaged under the order of any government or customs officials.</li> <li>6 Ionising radiation or radioactive contamination from nuclear fuel or nuclear waste or any risk from nuclear equipment.</li> </ol>

<sup>12</sup> Easyjet Insurance—10.12.06.

<i>Name of Insurance Company/Tour Operator</i>	<i>Potential Property Damage Benefit</i>	<i>Potential Injury Benefit</i>	<i>General Exclusions and Exclusions for Force Majeure Event</i>
Insureandgo.com <sup>13</sup>	Baggage delay £50 for every 24 hours Personal money Cash limit £200 Cash limit (aged under 18) £50 Passport and travel documents £100	Medical and other expenses £5,000,000 Personal accident: Loss of limbs or sight (aged under 66) £20,000 Permanent total disablement (aged under 66) £20,000 Death benefit (aged 18 to 65) £5,000 Death benefit (aged under 18) £2,500 All benefits (aged 66 and over) £2,500	We will not cover the following. Any claim arising out of war, civil war, invasion, revolution or any similar event. Loss or damage directly or indirectly caused by any government, public or local authority legally taking or damaging your property. Any claim arising from civil riots or strikes or industrial action of any kind (except for strikes or industrial action which were not public knowledge when you booked your trip). Loss of or damage to any property, or any loss, expense or liability arising from: a ionising radiation or contamination by radioactivity from any nuclear fuel or from any nuclear waste from burning nuclear fuel; or b the radioactive, toxic, explosive or other dangerous properties of any explosive nuclear equipment or any part of it. Legal expense cover will not be provided for claims against the insurance company, their agents or representatives, tour operator, provider of accommodation, carrier or any person that you have travelled with or arranged to travel with.

In conclusion, the holidaymaker is stripped of any real protection. The failure of Consumer Protections, and the rush to push further responsibility upon the holidaymaker surely requires a balance in the insurance contract, or at the very least, a clear notification to the intending purchaser of how limiting the travel insurance policy is?

The selling of policies with expertly worded exclusions will prevent the travel consumer from a just recovery. We consider that without a simplified contract, promoting open disclosure, leads to the conclusion that the “*force majeure*” distinctions potentially leads to the accusation of misselling. After all, what benefit would our imaginary holidaymaker receive under any of these policies? Consumer protection policies are failing him, insurance policies are failing him, is it right that multi-million pound industries should continue to enjoy this monopoly at the expense of the consumer, government or taxpayers?

#### A FAMILY FAILED

During the course of our oral evidence to the Select Committee, we cited the recent example of a holiday experience of one client in Turkey.

For that family, their holiday sadly ended in disaster. Their son became seriously injured whilst using an ill-supervised hotel swimming pool. Their son suffered a head injury, and was treated at a local hospital. Upon their return to the United Kingdom, he underwent further treatment at hospital, and has been found to have suffered permanent brain injury<sup>14</sup>.

This and other similar tragic events, often leads holidaymakers to seek ways in which they can investigate the event that led to serious injury/illness, and when that enquiry leads to a frustrating conclusion, they will then try to promote their complaint through legal action.

When lawyers are faced with that initial complaint, they are required to make extensive investigations as to insurance cover to help pay for legal bills, before they can make an offer to pursue a claim under a “no win no fee” arrangement.

If we refer to the previous section, we can see through the 4 insurance summaries, that each prevent the “insured” from promoting their claim against the tour company or the carrier, in one case, Ryanair, you are prevented from using the policy in a group action scenario.

Instantly, our family are disadvantaged from pursuing a legal claim, with the benefit of legal insurance to pay their legal bills. This is important if the lawyer believes that he could not share the risk on funding a claim—it effectively means that unless they are willing to pay for their legal bills, their choice on legal representation is limited. This is not an unusual concern; it is well known that many claims in Turkey can

<sup>13</sup> Insureandgo.com Travel Insurance—10.12.06.

<sup>14</sup> HTW—LG.

take many years to resolve, and whilst our family could potentially bring a claim against their tour operator under the Package Travel Regulations, they would be faced with the prospect of high legal bills to pursue their claim.

It raises the very serious question; why sell an important benefit if so few people can take advantage of it? Is this not misselling? Do the exclusions, presumably written and agreed between the insurer and the tour operator/carrier suggest collusion; does this not suggest an industry wide agreement, a cartel? Even if the benefit were available, many companies will not allow solicitors outside their own "back office" to handle the claim, what does that say about the state of freedom to choose your solicitor?

In our enquiry, we were alarmed to discover the limitation on young and old to recover a sufficient or reasonable payout for serious or permanent injury. Most serious payouts are limited up to £20,000. In the Easyjet summary above, we can see that payout is excluded for permanent physical injury for those of 15 years or under or over 71 years, why?

If our family had purchased the Easyjet policy, not only would they have been prevented from obtaining a payout for their son (who is under 15), money which could be used for paying expenses, nursing or respite care, but they would have been prevented from using the legal expenses insurance against the tour operator.

We ask the question again, is this responsible selling? If this family hold a similar policy, did their travel agent make sufficient enquiries of their needs before any policy was sold? Did the policy they purchased provide sufficient information; was it easily readable or understandable to prompt them to consider any limitations of benefit?

It was stated by ABTA that the Code of Conduct was a robust product, ensuring a high professional standard from their members. Consider this. We receive many complaints from holidaymakers about the lack of response from their tour companies. The ABTA Code of Conduct requires that its members respond within a certain timeframe. Sadly many do not. If the Code is not able to guarantee or enforce a simple acknowledgement, or response to a travel complaint, what then is the real position of the operation of Rule 1.7? The truth in this family's case, whatever policy they bought, they are very likely to experience a failure of that policy, in one aspect or another. How many times will that failure be repeated in all travel policies sold?

## CONCLUSION

In closing, we would ask the Select Committee and the Treasury Department to consider the documentary and oral evidence of this organisation. We call for urgent consideration is given to the sale of travel insurance policies; in particular we ask that:

1. Insurance Contracts are produced in an industry wide standard format, with clear explanations of the benefits, alongside clear explanations of exclusions;
2. An urgent enquiry be carried out into the operation of the ABTA Code of Conduct insofar as the sales of travel insurance products are concerned;
3. Consideration be given to incorporating the sales of all travel insurance products to regulatory control;
4. An urgent enquiry is carried out into the misselling of the travel insurance product insofar as it relates to the legal expense insurance element. We consider that such an enquiry should be implemented by the Office of Fair Trading.

Our concern is not only grounded in experience, but it is also now within the real potential for de-packaging or de-regulation in the package travel industry, that raises most concern. We refer to the small and as yet isolated clause within the insureandgo product. We have demonstrated that this prevents the travel consumer from using the legal expense portion of the product, against "providers of accommodation".

How many other companies will now follow suit? Will the agents or tour operators comply with their obligations under the ABTA Code of Conduct? How will the consumer be able to see beyond the simple document detailing the "benefits"?

This is the beginning of deconstruction; a deconstruction we suggest will lead to a greater detriment to the ordinary travelling consumer, and in some cases the British taxpayer.

*December 2006*

### Memorandum submitted by Which?

#### INQUIRY INTO THE SCOPE OF THE FSA INSURANCE REGULATION

In April 2003 and again in July 2006, Which? published research into the sale of travel insurance. We have attached these articles for the Committee's information.

Currently, "add on" travel insurance is not regulated by the Financial Services Authority. This type of policy is commonly sold as part of a holiday package by travel agents. Travel insurance sold as a "stand-alone" product is regulated.

Which? believes there is no reason why travel agents should be excluded from insurance regulation. People should have the same protection and peace of mind on holiday regardless of where they have brought their travel insurance.

Our research has shown that most travel agents visited failed to ask basic questions about medical history and consistently failed to adequately explain the nature of the cover and exclusions. Without covering the basic information requirements, it is more likely that people will be sold an unsuitable policy that may not receive adequate cover. Worryingly, if you are mis-sold an "add on" policy, as it is not regulated, you do not have access to the Financial Ombudsman Service.

Which? welcomed the Treasury's announcement in the summer that they will be publishing a consultation document into the inclusion of travel agents under the Financial Services Authority's general insurance regulation. We will be taking part in the consultation process.

In addition to the articles, I have attached a short summary of the results from our latest research.

*November 2006*

#### SALE OF TRAVEL INSURANCE

##### RESULTS FROM JULY 2006

#### SALE OF TRAVEL INSURANCE (JULY 2006)

Which?'s undercover researchers got insurance quotes from travel agents and over the phone and online from banks and insurers. Travel agents came out the worst.

#### TOPLINE RESULTS:

Travel agents' policies are generally more expensive than others sold on the market.

- None of the travel agents visited followed all three of the procedures that would help ensure policies are suitable; explaining what's covered, making clear what's excluded and asking about pre-existing medical conditions.
- Almost two thirds (17 out of 26) of travel agents failed to ask about medical histories.
- Most agents (21 out of 26) didn't explain what the policies covered.
- None pointed out what wasn't covered. (This makes it more likely people will be sold an unsuitable policy that may not receive adequate cover.)
- Banks and insurers did better than travel agents, but there's still room for improvement. As banks and insurers are regulated by the Financial Services Authority, people sold an unsuitable policy can go to the Financial Ombudsman Service for help. Travel agents are not regulated in this way.

*November 2006*

---

### Memorandum submitted by the Civil Aviation Authority: Consumer Protection Group

#### INTRODUCTION

1. The Civil Aviation Authority (CAA) is a public corporation established in 1972. It is the UK's independent aviation regulator, with responsibility for all civil aviation regulatory functions (economic regulation, airspace policy, safety regulation and consumer protection).

2. The Consumer Protection Group is the part of the CAA responsible for taking forward its duties in relation to providing consumer protection for holidaymakers. It fulfils its remit by:

- Licensing and regulating the finances and fitness of travel organisers selling flights and package holidays in the UK through the Air Travel Organisers' Licensing (ATOL), the UK's largest system of consumer protection for travellers;

- Licensing UK airlines and enforcing European Union requirements in relation to their finances, nationality and insurance; and
- Enforcing certain other legal requirements and codes of practice for protection of airlines' customers; for example in relation to denied boarding compensation.

3. The Group was invited to submit evidence in response to the Treasury Select Committee's call for evidence on the subject of travel insurance regulation in order to assist the Committee with information on wider aspects of consumer financial protection in travel. We hope that our submission assists the Committee in its inquiry, and we would of course be very happy to provide additional information, if required, either in writing or in oral evidence.

#### THE CAA'S ROLE IN UNDERPINNING FINANCIAL STABILITY AND FINANCIAL PROTECTION

4. Since 1972 UK consumers purchasing air holidays and flights from travel organisers (including tour operators) have been protected through the ATOL scheme, which licenses firms and ensures financial protection is in place to protect consumers in the event of insolvency.

5. Licensing was introduced to test the financial fitness of companies wishing to offer air holidays and flights in order to reduce the risk of failure. It is a requirement of a licence that firms provide bonds to the CAA to finance the arrangements to repatriate and refund consumers affected by a failure. The CAA's licensing requirements aim to provide stability and give consumers the confidence to be able to book and pay for their air packages well ahead of departure.

6. Since 1991 the Package Travel Directive (PTD)<sup>1</sup> has required companies selling package travel to meet specified consumer protection requirements including liability for the packages sold, the protection of monies paid over against insolvency, and repatriation.

7. In the UK, the PTD is implemented through the Package Travel Regulations (PTR).<sup>2</sup> The way in which the insolvency protection requirement is met for air holidays is through ATOL, and this is recognised in the Regulations. Over 26 million consumers and £15 billion are protected each year as a result of passengers booking holidays through 2,500 ATOL licence holders.

8. In the year to March 2006, the ATOL scheme repatriated or refunded more than 23,000 holidaymakers and paid out more than £9 million to consumers. In the past 20 years, the scheme has repatriated more than 202,000 people, preventing them being stranded abroad, and refunded more than one million others, to a total value of £184 million.

9. It is worth noting that ATOL protection does not extend to package holidays not involving air travel eg coach tours. For these types of holiday, trade associations like ABTA, the FTO, CPT, PSA and AiTO are recognised by the DTI as ensuring financial protection for their tour operator members' customers. There is no licensing requirement for non-air holidays.

#### RECENT CHANGES IN THE AIR TRAVEL MARKET

10. With the development of low-cost airlines, home-ownership abroad and on-line shopping over the Internet, increasing numbers of leisure travellers are now making their travel arrangements independently, buying their flights and accommodation directly from airlines and accommodation suppliers rather than as part of a holiday package.

11. In 1997, 98% of leisure air passengers were ATOL-protected—but by 2005 this proportion had fallen to 61%. This reflects the growth in leisure air travel driven by flights and other holiday arrangements, such as villas and hotels, booked independently. The absolute number of ATOL-protected passengers has not fallen in a similar way and remains relatively stable at around 26 million.

12. An effect of these market changes is that an increasing number of overseas holidays now fall outside PTD and the ATOL scheme. People who buy holidays in this way would not be protected for refunds and repatriation in the event that their airline or accommodation supplier became insolvent. Such consumers can protect themselves by taking out appropriate insurance, such as Scheduled Airline Failure Insurance (SAFI). However, a key point is that there is considerable confusion over the cover provided by personal travel insurance—many believe that insolvency is covered when in fact policies exclude this in most cases.

13. The Government has been working with the airline industry to help passengers learn more about air travel insurance.<sup>3</sup> It has sought to encourage airlines to offer appropriate SAFI cover, and some—eg BA, Flybe, easyJet and Ryanair—have amended the travel insurance they sell so as to include SAFI. Some of the low cost carriers have agreed a voluntary repatriation scheme amongst themselves.<sup>4</sup> This scheme is subject to restrictions, and it does not provide the same comprehensive protection enjoyed by package travellers under ATOL.

<sup>1</sup> Council Directive 90/314/EEC package travel, package holidays and package tours.

<sup>2</sup> Package Travel, Package Tours and Package Holidays Regulations 1992.

<sup>3</sup> This is illustrated in a Department for Transport press release, which can be viewed at: <http://www.gnn.gov.uk/environment/fullDetail.asp?ReleaseID=172725&NewsAreaID=2&NavigatedFromDepartment=False>

<sup>4</sup> <http://www.elfaa.com/documents/ELFAAPRESSRELEASEATOLissue—101005—3.pdf>

---

 CONSUMER AWARENESS AND EDUCATION

14. There is consumer confusion about the role of ATOL, ABTA, and travel insurance in providing financial protection against insolvency. There is consistent evidence from surveys<sup>5</sup> showing that a large proportion of air travellers who buy holidays that are not protected assume that they are, and that they are unaware of the need to make their own arrangements, such as taking out SAFI. Passengers can “self insure” because their flight was an inexpensive purchase, and airline bankruptcies are not everyday occurrences. However this needs to be a clearly informed decision.

15. Travellers face other risks besides airline and tour operator insolvency (eg medical costs abroad and, less commonly, crime or terrorist incidents). The FCO consistently encourages travellers to take out insurance as consular services have limits, and the current Treasury consultation document draws attention to several common exclusions in travel insurance.

## COURT OF APPEAL JUDGMENT ON THE DEFINITION OF A “PACKAGE”

16. In March 2005, after extensive consultation with travel industry representatives, including ABTA, the CAA published guidance on the sale of air package and the need to provide consumer protection. The guidance was intended to help travel organisers and agents understand the definition of an air package and which parts of their business need to be covered by an ATOL.

17. Following publication of the guidance, ABTA sought and was granted permission for a Judicial Review, which took place in late 2005. In January this year the High Court quashed the guidance.

18. The CAA appealed to the Court of Appeal, because it believed the ruling made it difficult for a consumer to make an informed decision. The Court of Appeal Judgment published on 17 October 2006 ordered the Guidance Note to be withdrawn, but on a number of issues took a different view than the original outcome of the Judicial Review in January 2006.<sup>6</sup>

19. The CAA set out its views on the Judicial Review Appeal Judgment in a press release on 14 November 2006.<sup>7</sup> Its main points are:

- “Dynamic packages” which include flights require ATOL protection.
- Travel components sold in combination and at a price which covers all of the components are a “package”, irrespective of how the sale is documented or the capacity in which the organiser claims to act.
- In the case of services being sold or offered for sale as components of a pre-arranged combination, then the price for the combination is an “inclusive price” regardless of whether the price for the combination is the total (or aggregate) of the component prices.
- The term “pre-arranged combination” applies not only where the components are put together by the organiser without input from the customer (typically, as is the case with a brochure holiday), but also where the components are put together by the organiser in accordance with the specifications of the individual customer (typically a “customised” holiday). And the requirement is satisfied not only in cases where the components have been put together and offered for sale by the organiser in advance of any contact with the individual customer, but also in cases where the combination of tourist services is the result of the wishes expressed by the customer up to the moment when the parties reach agreement and conclude the contract.
- Components sold separately are unlikely to be protected, and could potentially leave customers stranded abroad and out of pocket if the retailer fails, and with no comeback to a UK based travel provider if anything goes wrong with their holiday arrangements.
- Consumers need to be able to make a properly informed choice between securing ATOL protection or not—otherwise consumers will not know whether or not they are protected, and may find themselves without recourse to a UK travel provider if there are problems with their holiday arrangements, including health and safety issues.

## CONCLUDING REMARKS

20. There is considerable consumer confusion about when financial protection applies to holidays involving air travel and we have some concerns about whether consumers are able to make informed decisions. The CAA is committed to working with DTI, DfT and others to ensure consumers make informed decisions. It will though be important for (unlicensed) travel agents to have a dialogue with customers about the areas of risk that are covered by ATOL (and other bonding schemes) so that consumers do not incur the additional costs of unnecessary insolvency insurance.

---

<sup>5</sup> “Financial protection for air holidays”, NFO Transport & Tourism. May 2003. CAA Consumer Survey, March 2006. <http://www.caa.co.uk:pressnotice11.2> million Consumers Risk “DIY” Summer Holiday Danger—CAA News—CAA

<sup>6</sup> The Judgement can be viewed at <http://www.caa.co.uk/docs/33/Judgment—17—10—06.pdf>

<sup>7</sup> The press release, Dynamic packages require ATOL protection, can be viewed at <http://www.caa.co.uk/application.aspx?categoryid=14&pagetype=65&applicationid=7&newstype=n&mode=detail&nid=1371>

21. We hope that the Committee will agree that travel agents and others selling travel insurance should inform consumers clearly about whether their holiday enjoys ATOL protection, and what that means in practice. They should also explain exemptions in the insurance policies they are selling.

*December 2006*

---

### Memorandum submitted by the Office of Fair Trading

#### INTRODUCTION AND SUMMARY

1. This submission is made in response to the Treasury Committee's inquiry into the scope of FSA insurance regulation. The Committee is seeking written evidence on:

- The current extent of regulation of the insurance market.
- The need for, and potential effects of, extending regulation to the bundled travel insurance and extended warranty markets.
- The form any proposed future regulation might take, including models for non-statutory regulation.

2. Details of the OFT's role in respect of travel insurance and extended warranties on domestic electrical goods are set out in annex 1.

3. The Office of Fair Trading's (the OFT) mission is to make markets work well for consumers. Although the OFT has no specific responsibility for regulating insurance business it does, however, have powers to enforce consumer protection legislation, review markets and act against anti-competitive conduct. This means that the OFT continues to actively participate in this sector. The OFT works closely with the Financial Services Authority (FSA) to ensure that regulation is proportionate to the risks facing consumers and is effective in deterring or preventing abusive behaviour.

4. The OFT has responsibility for monitoring and review of Orders that apply to extended warranties and foreign package holiday travel insurance, made following Competition Commission (CC) inquiries into these sectors. This work is ongoing and allows the OFT to intervene should it uncover evidence of non-compliance, ineffectiveness or new features which may be affecting competition in the markets examined by the CC.

#### CURRENT REGULATION OF THE INSURANCE MARKET

##### *The OFT's role*

5. The OFT does not regulate insurance markets. However, it has a range of powers to protect consumers or competition that allow it to act in all markets where there is evidence of significant harm to consumers. These include:

- Enforcement action of consumer protection legislation, for example the Unfair Terms of Consumer Contracts Regulations 1999, or support of self regulation through the OFT's Consumer Codes Approval scheme.<sup>1</sup>
- Market studies or market investigation references to the Competition Commission and monitoring and review of existing remedies.
- Investigation of anti-competitive conduct under the Competition Act 1998.

##### *Cooperation with the FSA and recent joint working*

6. The OFT's role complements that of the FSA. Both organisations are committed to working together to ensure that their activities are as joined-up as possible and thereby provide both consumers and business with an efficient and effective enforcement and regulatory system which does not impose unnecessary administrative burdens.

7. A Joint Action Plan was published in April, which covered the areas of mutual interest of the OFT and the FSA and set out a series of pieces of work to be undertaken to ensure that collaboration between the OFT and the FSA was as good as possible. An example of this collaboration is the current study into payment protection insurance. The OFT has published its provisional market study report on payment protection insurance, setting out its intention to make a market investigation reference to the Competition

---

<sup>1</sup> This scheme is designed to improve consumer confidence in the customer service that businesses offer, such as the information provided to the consumer and resolution of problems if they occur. More information can be found on our website at [www.offt.gov.uk/Codes/default.htm](http://www.offt.gov.uk/Codes/default.htm)

Commission. It is engaged in statutory consultation on the proposed decision, running to 30 November. Payment protection insurance has been subject to FSA regulation since January 2005 and the OFT is working closely with the FSA on this study.

#### BUNDLED TRAVEL INSURANCE AND EXTENDED WARRANTIES

8. Annex 1 sets out the existence and scope of Orders relating to extended warranties on domestic electrical goods and the supply of foreign package holiday insurance. These Orders came into force after references to the Competition Commission, or its predecessor the Monopolies and Mergers Commission, as remedies for features identified in the course of those inquiries which were preventing, restricting or distorting competition in these markets and therefore not delivering value to consumers. The OFT is responsible for monitoring Orders and reviewing the effectiveness of remedies.

9. The Supply of Extended Warranties on Domestic Electrical Goods Order 2005 came into force in April 2005. The OFT has received only one complaint about a possible breach of this Order and is looking into several other cases where breaches may have occurred. In addition, the OFT is collaborating with a London School of Economics study that is evaluating the market impact of the Order. This study should provide the OFT with a useful insight of whether problems remain that the OFT should act upon, ahead of first review.

10. For travel insurance, the OFT has continued to monitor compliance with the Foreign Package Holidays (Tour Operators and Travel Agents) Order 2001. There have been no complaints or other compliance issues in relation to the Order on travel insurance on foreign package holidays.

#### THE FORM OF PROPOSED FUTURE REGULATION

11. In general, the OFT favours a market solution where there is significant risk to consumers from ineffective competition or distortions to the competitive process, coupled with effective arrangements for consumer redress from unfair practices. In some cases regulation may contribute to distortions of competition.

12. This possibility is recognised, for example, in the FSA's focus on risk-based regulation and their process of cost-benefit analysis to ensure regulation is proportionate. The OFT has a role overseeing FSA regulations to ensure they do not have a significant adverse effect on competition.<sup>2</sup>

13. Where regulation may be extended, the OFT considers that a sound case for intervention is needed. This is particularly the case where an ongoing regulatory burden may be placed on stakeholders.

*November 2006*

**Annex 1**

### EXTENDED WARRANTIES ON DOMESTIC ELECTRICAL GOODS AND TRAVEL INSURANCE ON FOREIGN PACKAGE HOLIDAYS

#### A. INTRODUCTION

1. Under section 162 of the Enterprise Act 2002, the OFT has a duty to “keep under review the carrying out of any enforcement undertaking or enforcement Order” made pursuant to an inquiry by the Competition Commission.<sup>3</sup> This includes undertakings and Orders made under the monopoly provisions of the Fair Trading Act 1973 (‘FTA’).<sup>4</sup>

2. There are enforcement Orders in place relating to the supply of extended warranties on domestic electrical goods and the supply of foreign package holiday insurance. These are discussed below.

3. The OFT monitors Orders and undertakings and takes action where it believes they are not being complied with.

4. Orders and undertakings are reviewed from time to time and, if there has been a change in circumstances since the remedies were put into effect, they may be varied or revoked. Alternatively, under section 131 of the Enterprise Act, a new market investigation reference may be made to the Competition Commission if the OFT suspects that a feature or combination of features in the market concerned prevents, restricts or distorts competition.

---

<sup>2</sup> This role is set out in section 160 of the Financial Services and Markets Act 2000.

<sup>3</sup> Formerly called the Monopolies and Mergers Commission.

<sup>4</sup> The relevant sections of the Fair Trading Act 1973 are still in force by virtue of Schedule 24 of the Enterprise Act 2002.

---

## B. EXTENDED WARRANTIES

### *Background to OFT involvement*

5. On 18 December 2003, the Competition Commission ('CC') published its report on the supply of extended warranties on domestic electrical goods, and identified a number of features which it said was distorting competition in the supply of extended warranties in the UK.<sup>5</sup>

6. The CC found that a complex monopoly situation existed in the supply of extended warranties ('EWs') which operated against the public interest. This resulted in:

- a lack of choice;
- excessive prices;
- insufficient information;
- lack of competition at point of sale;
- employing selling practices which left customers feeling under unreasonable pressure;
- disadvantageous terms; and
- lack of information about the scope of protection.

7. As a result of the recommendations made by the CC, the Supply of Extended Warranties on Domestic Electrical Goods Order 2005 ("the Order") came into force in April 2005.<sup>6</sup> The Order addresses the above concerns and stipulates a number of conditions relating to the sale of extended warranties. Among these are:

- the price of an EW is displayed alongside the price of the good in store and in press advertisements and other publicity where the good is advertised;
- standard information is provided to consumers setting out information on statutory rights and the availability of EWs elsewhere; and
- improved cancellation rights, including an option to cancel an extended warranty and get a full refund within 45 days from purchase, and thereafter to pro-rata any refund.

### *Market background*

8. The CC in its 2003 report<sup>7</sup> estimated the annual value of the domestic electrical goods market in the UK at £15-20 billion. In round figures, the annual volume of extended warranties (EWs) purchased in the UK is about 19 million and their annual value about £900m. About 80% of new EWs are provided by the top five retailers at the point of sale of the domestic electrical goods<sup>8</sup>. This is therefore a significant market. The CC also estimated that the top five EW retailers had, between 1997 and 2001, collectively earned on average £116—£152 million more profit each year than they would have earned under fully competitive conditions.

9. The Committee should also be aware that following two reports published by the Monopolies and Mergers Commission (before it became the CC) on certain domestic electrical goods<sup>9</sup>, the Supply of Domestic Electrical Goods Order came into force in 1998, which prohibited suppliers' practice of restricting or recommending prices to retailers of domestic electrical goods, and discriminating between different dealers.<sup>10</sup>

10. In addition, statutory undertakings were given in 1998 by Combined Independents (Holdings) Ltd and its members, Dixons Group plc and Empire Stores Limited. The undertakings are designed to stop these retailers using suppliers to influence the resale prices of certain domestic electrical goods by these and other retailers.

---

<sup>5</sup> Extended warranties on domestic electrical goods—a report on the supply of extended warranties on domestic electrical goods within the UK', Competition Commission, 18 December 2003. <http://www.competition-commission.org.uk/rep—pub/reports/2003/485xwars.htm#summary>

<sup>6</sup> For a copy of the Order, please see: <http://www.ofc.gov.uk/NR/rdonlyres/D292EE9A-C0AA-424F-9DA0-D0C377249830/0/ExtendedWarrantiesonDomesticElectricalGoods—1.pdf>

<sup>7</sup> "Extended warranties on domestic electrical goods—a report on the supply of extended warranties on domestic electrical goods within the UK", Competition Commission, 18 December 2003.

<sup>8</sup> Dixons, Comet, Powerhouse, Littlewoods and Argos.

<sup>9</sup> "Domestic Electrical Goods: I A report on the supply in the UK of televisions, video cassette recorders, hi-fi systems and camcorders" and "Domestic Electrical Goods: II A report on the supply in the UK of washing machines, tumble dryers, dishwashers and cold food storage equipment", Monopolies and Mergers Commission, 15 August 1997.

<sup>10</sup> For a copy of the undertakings, please see: <http://www.ofc.gov.uk/NR/rdonlyres/04B83194-59EE-4753-A9C7-877DB7EB24AC/0/domesticelectricalgoods2.pdf>

*Monitoring and enforcement of the Order*

11. We monitor the market, primarily by examining retailers' web sites, but also by the occasional visit to retailers' premises, to ensure that the Order is being complied with. We have received only one complaint about a possible breach of the Order and we are following up with other retailers where we have concerns about possible non-compliance.

*London School of Economics—OFT collaboration on the supply of extended warranties for domestic electrical goods*

12. The LSE is conducting a study to evaluate the effectiveness of the Order in addressing the adverse effects on competition identified by the CC's report since its introduction on 6 April 2005. The study is focusing on:

- the impact of the Order on the market; and
- the impact of the Order on consumer behaviour.

13. The study is due to finish in March 2007. It will be useful in informing us about how the market might have changed since the Order came into force and whether there are issues or problems with compliance or consumers' awareness of their rights which we might need to act on.

## C. TRAVEL INSURANCE ON FOREIGN PACKAGE HOLIDAYS

*Background to OFT involvement*

14. Following a monopoly reference by the then Director General of Fair Trading of the supply of foreign package holidays, the Monopolies and Mergers Commission found, among other things that an insurance-discount tie enabled travel agents to inflate the advertised discount on foreign package holidays by reason of the sometimes large margins made on the sale of insurance. The adverse effect was that consumers were misled by the discounted offer into thinking they are receiving a greater discount on the holiday they are purchasing than in fact they are, with the result that they shopped around less and obtained less value for money than they otherwise would.

15. Following on from the MMC enquiry, the Foreign Package Holidays (Tour Operators and Travel Agents) Order 2001<sup>11</sup> came into force in August 2001. Among other things not related to the insurance issue, the Order makes it unlawful for travel agents or tour operators to discriminate against customers who do not purchase travel insurance from the travel agents or tour operators.

*Market background*

16. According to recent Keynote reports (October 2006), the internet and the availability of low cost flights overseas has reduced the share of consumers' expenditure accounted for by package holidays. Growth in foreign holidays has outstripped that in domestic ones in recent years. However, the growth in the total volume demand for holidays has not exceeded growth in economic activity in recent years; nor has the total value of the UK holiday market increased at a faster pace than the economy. Traditional travel agents and tour operators face an increasing and large threat from internet traders.

*Monitoring and enforcement of the Order*

17. There have been no complaints to us about non-compliance. Recently, we checked travel agents' and tour operators' standard terms and conditions to check that insurance was not being tied in to foreign package holidays by means of the offer of discounts: no breaches of the order were found.

**Annex 2**

TREASURY COMMITTEE INQUIRY INTO THE SCOPE OF  
FSA INSURANCE REGULATION

We are not aware of any particular compliance activity by Local Authority Trading Standards Services (TSS) in relation to the Extended Warranties Order. We normally expect them to notify us of any such activity, given our role in relation to the enforcement of the Order. We have spoken to the Trading Standards Institute which was similarly unaware of any initiatives by its members on the Order.

You ask whether we have received general complaints about extended warranties (not necessarily concerning the Order). Consumer Direct, which became an OFT responsibility in April of this year, received some 570 complaints and enquiries on extended warranties for domestic electrical goods in 2005 and has

<sup>11</sup> See <http://www.opsi.gov.uk/SI/si2001/20012581.htm>

---

received about 700 this year to date. As Consumer Direct only achieved full national coverage in October this year, comparison between years should be treated with caution. Separately, the OFT has received 22 complaints and enquiries on extended warranties for all products in 2006.

The research project being run by the London School of Economics is in its very early stages and as yet there are no results to report. We expect to be in a position to provide some insight into the finding around March 2007. The review of the Extended Warranties Order, while provisionally scheduled for 2007, is not yet under way so we are not able to add anything to the information provided on monitoring at this time. Our experience is that it is difficult to gain a clear picture on the full extent of effectiveness of remedies until they have been operational for a minimum of three years.

ABTA decided to withdraw from the Consumer Codes Approval Scheme (CCAS) in September when it changed its financial protection arrangements. The new arrangements will not protect consumers' deposits and prepayments to the same extent as the OFT approved ABTA code. We were disappointed with ABTA's decision to change its code and withdraw from the scheme. The OFT has no reason to believe that ABTA's code is not effective other than that it no longer complies with the CCAS criterion on protection of prepayments.

---

### **Letter from the Office of Fair Trading to ABTA**

#### **ABTA'S CODE OF CONDUCT**

Thank you for your letter of 24 November where you express concern about the OFT's oral evidence to the Treasury Committee inquiry into the scope of FSA regulation. Your concern is specifically about responses made by the OFT in relation to enquiries as to whether voluntary codes of conduct work well.

The OFT's comments were intended to relate specifically to OFT Approved Codes and whether ABTA's code fully meets the criteria for the Consumer Codes Approval Scheme. As you state, ABTA's voluntary code no longer meets this standard as a result of changes it made to its payment protection scheme and ABTA withdrew from the Approved Codes Scheme on 1 September.

Mr Williams noted, in response to the Committee on the question of whether ABTA's code was effective, that the OFT had no reason to think ABTA's code was not effective other than it no longer complies with the criterion concerning protection of pre-payments and deposits. However, we do consider that this issue is significant. It was not our intention to imply that ABTA's code of conduct as a whole was ineffective.

I have written to the Treasury Committee in order to clarify the OFT's position and have also provided it with further information on how the Approved Codes scheme operates.

I am pleased to note that you will shortly be meeting the Code Team and other OFT staff and hope that discussions regarding your possible future participation in the Consumer Codes Approval Scheme can continue.

*December 2006*