

# DISTANCE MARKETING OF INSURANCE PRODUCTS TO CONSUMERS IN THE UK

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In October 2004, the UK implemented the EU Directive<sup>2</sup> concerning the distance marketing of consumer financial services (the **Directive**) by secondary legislation<sup>3</sup> (the **Regulations**) and amendments to parts of the Handbook of Rules and Guidance (the **FSA Rules**) issued by the Financial Services Authority (the **FSA**). The final piece of the jigsaw fell into place on 14 January 2005 when the FSA's Insurance: Conduct of Business Sourcebook (**ICOB**), which forms part of the FSA Rules, came into force.

The Directive applies to all life and property/casualty insurance policies, as well as contracts for other financial services, entered into between suppliers and consumers exclusively using the telephone, a website or other means of distance communication, including post. This article examines the implementation of the Directive in the FSA Rules and considers the implications for insurers and insurance intermediaries (referred to in this article as **suppliers**).

The FSA Rules apply to suppliers selling insurance products anywhere in the EEA<sup>4</sup> from an establishment (including a branch of a non-EEA insurer) in the UK. Certain aspects of the FSA Rules will apply to a US firm which provides insurance directly into the UK (see *Cross-border regulation* below); additionally, where a broker based in the UK is involved in the sale of insurance underwritten by a US firm, that broker will be obliged to provide the information set out in *Information requirements before conclusion of the contract* below, although in neither case will the provisions relating to cancellation rights apply.

## *Contracts to which the Directive applies*

### Distance contracts

A "distance contract" is a contract for financial services concluded under an *organized* distance sales or service-provision scheme run by the supplier, who, for the purpose of that contract, makes *exclusive* use of one or more means of distance communication up to and including the moment the contract is concluded<sup>5</sup>. A supplier who enters into a one-off or occasional transaction by distance means is probably not covered by the FSA Rules.

A "means of distance communication" is any means which does not involve the simultaneous physical presence of those parties<sup>6</sup>. It is unclear from the additional guidance provided by the FSA Rules whether the contract will be treated as a distance contract where, for example, a person collects a leaflet from a branch, fills in an application form and posts it back without ever speaking to a representative of the supplier in person. While a firm selling into the UK from abroad will almost certainly be using a means of distance communication, and therefore will be engaged in distance marketing caught by the FSA Rules, any firm which has an office in the UK which is open to retail customers or whose employees may have face-to-face contact with retail customers, will need to consider to what extent the distance marketing aspects of the FSA Rules apply.

### Retail Customers

Although the Directive refers to "consumers", the FSA Rules adopt the concept of a "retail customer", meaning "an individual who is acting for purposes which are outside his trade, business or profession"<sup>7</sup>. The FSA Rules provide guidance in relation to a number of unclear circumstances. If in doubt, the supplier is obliged to treat a customer as a retail customer<sup>8</sup>.

## *Information requirements before conclusion of the contract*

### General requirements

A supplier must provide its retail customer with detailed information<sup>9</sup>, including the following:

- A policy summary. This must set out brief details of the policy, the right of cancellation (as to which, see *The right of cancellation* below), contact details to notify a claim, and complaints and compensation information.
- A statement of price. As well as details of the premium (or the means by which the premium is calculated) and the total price payable, this must contain information on fees, administrative charges and taxes payable in addition to the premium. If the contract is to be purchased with other goods and services, the premium must be set out separately from all other prices relating to the goods or services.
- The policy document, which must contain all the terms and conditions of the contract with the retail customer.
- Information about the claims handling process.

The supplier must communicate this information to the retail customer in a durable medium<sup>10</sup> in good time *before* the retail customer is bound by the distance contract or offer<sup>11</sup>. This requirement will force many suppliers to change their procedures, since it has been common practice to supply the contractual documentation as part of a package sent only *after* conclusion of the contract.

### **Telephone sales**

If the service is being provided by telephone, the supplier must provide the retail customer with its name and, if the call was initiated by the supplier, the commercial purpose of the call. If the retail customer gives his explicit consent to receiving only limited information, the supplier may provide the abbreviated information orally before conclusion of the contract<sup>12</sup>. The supplier must provide the full package of information (referred to in *General requirements* above) immediately after conclusion of the contract.

The same information should be provided to a retail customer when any other means of distance communication is being used which does not enable provision of the full information set out above.

## ***The Right of Cancellation***

### **The Right**

A retail customer has an unconditional right of cancellation which is valid for a period of 14 days either from the date of the conclusion of the distance contract or from the date when the retail customer receives the contractual terms and conditions in a durable medium, whichever is later<sup>13</sup>.

This period is extended to 30 days in relation to:

- pure protection contracts<sup>14</sup>;
- life policies<sup>15</sup>; and
- appropriate personal pensions<sup>16</sup> and stakeholder pension schemes<sup>17</sup>.

In relation to pure protection contracts and life policies, the time limit begins from the time when either the retail customer is *informed* that the distance contract has been concluded or the retail customer receives the contractual terms and conditions in a durable medium, whichever is later.

This right of cancellation can be exercised by notifying the supplier on paper or other durable medium by post or by any other method notified to the retail customer by the supplier<sup>18</sup>. If the retail customer exercises his right of cancellation, the supplier must within 30 days return any sums received on conclusion of the contract. However, the supplier can (if it notified the retail customer prior to the conclusion of the contract that it would) require the retail customer to pay for any services provided before the exercise of the right of cancellation<sup>19</sup>.

### **Exceptions to the right of cancellation**

The right of cancellation does not apply to:

- travel and baggage insurance policies or similar short-term insurance policies of less than one month's duration; and

- contracts whose performance has been fully completed at the retail customer's express request before the retail customer exercises his right to cancel<sup>20</sup>.

#### **Automatic cancellation of "attached" distance contracts**

Where a retail customer cancels a distance contract any "attached" distance contract will be automatically cancelled<sup>21</sup>. An attached distance contract is any further contract for provision to the retail customer of a financial service by (i) the same supplier or (ii) a third party where the third party has an agreement with the supplier, and:

- the secondary contract is entered into pursuant to a term of the main contract;
- the main contract is financed by the secondary contract;
- the retail customer entered into the secondary contract for a purpose related to the main contract; or
- performance of the secondary contract requires performance of the main contract<sup>22</sup>.

An example of an "attached" distance contract which would be automatically cancelled if the distance contract is cancelled is any financing arrangement which the retail customer entered into through the supplier to pay premiums by instalments.

#### ***Prohibition on Abusive Market Practices***

#### **Fraudulent use of payment cards**

If a payment card (including a credit card, charge card, debit card or store card) is used fraudulently by a third party to pay for a distance contract, the Regulations apply whether the supplier is an FSA authorised person or not. The payment may be cancelled and the cardholder is entitled to reimbursement of any sums charged<sup>23</sup>.

No express provision is made in the Regulations for cancellation of any contract which has been paid for fraudulently. However, such a contract may be unenforceable at common law for want of consideration or voidable by the supplier for fraud by the retail customer.

#### **Passive sales**

A supplier must not provide any services to a retail customer without a prior request on the part of the retail customer if the supply of the service includes a request for immediate or deferred payment, and may not enforce any obligation on a retail customer in the event of the unsolicited supply of services<sup>24</sup>.

Care should be taken to ensure that any cold-calling script contains an introduction and then asks the prospective retail customer to confirm that he would be interested in having the proposed services provided to him.

The absence of a reply by a retail customer to any unsolicited contact cannot constitute consent either at common law or under the FSA Rules<sup>25</sup>.

#### **Remedies**

Consumers cannot waive their rights under the Directive<sup>26</sup>, and there is no provision in the FSA Rules to permit a retail customer to do so.

Under the Directive, Member States are obliged to ensure that the retail customer has adequate and effective means of redress, and this includes the availability of out-of-court settlement procedures for cross-border disputes<sup>27</sup>. The FSA has fulfilled this role since 31 October 2004; it has extensive statutory powers of investigation, fuller details of which are set out in the FSA's Enforcement manual (**ENF**). In addition, it is able to exercise power granted to it under the Financial Services and Markets Act 2000 (**FSMA**)<sup>28</sup> to require restitution to the appropriate person for any loss suffered. The FSA can also give regulated firms and persons private warnings<sup>29</sup> and public censures<sup>30</sup>, and levy financial penalties<sup>31</sup> on them.

In addition, the Directive requires that operators and suppliers of means of distance communications (for example internet service providers) can be obliged to take action, if they are in a position to do so, to put an end to practices that have been declared to be contrary to the Directive (for example unsolicited communications) via their service<sup>32</sup>. The FSA has the right to seek injunctions<sup>33</sup> against persons, whether or not authorised, to remedy a contravention of the FSA Rules.

## CROSS-BORDER REGULATION

The Directive is intended to operate on a "country of origin" basis, that is to say that each EEA State will implement the Directive in respect of suppliers based in that State; services provided in the UK from another EEA State will be regulated by the relevant authority in that EEA State. However, as permitted by the Directive, the FSA has included transitional provisions so that the FSA Rules apply to any supplier selling insurance products to retail customers in the UK from any EEA State which has not yet implemented the Directive<sup>34</sup>.

Insurance services provided directly into the UK from outside the EEA are subject to certain information requirements if:

- in respect of general insurance contracts, the state of the risk is the United Kingdom<sup>35</sup>; or
- in respect of pure protection contracts, the habitual residence of the retail customer is within the United Kingdom<sup>36</sup>.

A supplier must not provide services from outside the United Kingdom until it has disclosed in writing that in some or all respects the regulatory system applying to it (including complaints handling or compensation arrangements) will differ from that applicable in the United Kingdom<sup>37</sup>.

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<sup>2</sup> Directive no 2002/65/EC. A directive is legislation made by the European Union (EU) that is binding, as to the results to be achieved, upon each Member State to whom it is addressed, but leaves to national authorities the choice of form and method of implementation

<sup>3</sup> The Financial Services (Distance Marketing) Regulations SI 2004 No 2095

<sup>4</sup> The European Economic Area (EEA) is constituted by the Member States of the European Union and the European Free Trade Area (EFTA) (other than Switzerland). Current members of the EU are: Austria, Belgium, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, The Republic of Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, and the United Kingdom; members of EFTA are: Iceland, Liechtenstein, Norway and Switzerland

<sup>5</sup> Glossary to the FSA Handbook of Rules and Guidance (the **Glossary**)

<sup>6</sup> Glossary

<sup>7</sup> Glossary

<sup>8</sup> ICOB 1.2.6 R

<sup>9</sup> ICOB 5.3.6 R

<sup>10</sup> In addition to paper, "durable medium" includes, in particular, floppy disks, CD-ROMs, DVDs and any PC hard drive on which email is stored but not websites unless the customer can store information in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows unchanged reproduction of the information stored (Glossary)

<sup>11</sup> ICOB 5.3.6 R

<sup>12</sup> Full details of the abbreviated information required to be provided are set out in ICOB 5.3.6 R (2)

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- 13       ICOB 6
- 14       ICOB 6.2.2 R. A pure protection contract is a life assurance contract under which (a) the benefits are payable only on death or incapacity; (b) the benefits are payable on death (other than death due to an accident) only where the death occurs within ten years of the life being insured, or where the death occurs before that person attains a specified age not exceeding seventy years; (c) the contract has no surrender value, or the consideration consists of a single premium and the surrender value does not exceed that premium; (d) the contract makes no provision for its conversion or extension in a manner which would result in it ceasing to comply with any of (a), (b) or (c); and (e) the contract is not a reinsurance contract (Glossary)
- 15       COB 6.7.7 R. A life policy is a long-term insurance contract (other than a reinsurance contract and a pure protection contract), i.e., any contract of insurance falling within Part II of Schedule 1 to the Regulated Activities Order (SI 2001/544) (Contracts of long-term insurance)
- 16       COB 6.7.7 R. An appropriate personal pension is a personal pension policy (where the contributions are paid to an insurer) or a personal pension contract (where the contributions are paid to a collective investment scheme) under which contributions are made to a personal pension scheme (a scheme of investment in accordance with section 630 of the Income and Corporation Taxes Act 1988) which is an appropriate scheme under section 1(8) of the Social Security Act 1986 or article 3(8) of the Social Security (Northern Ireland) Order 1986
- 17       COB 6.7.12R
- 18       ICOB 6.3.1 R and COB 6.7.42 R
- 19       ICOB 6.4.3 R
- 20       ICOB 6.1.5 R
- 21       Regulation 12
- 22       Regulation 12(2)
- 23       Regulation 14
- 24       ICOB 4.7.1 R (1)
- 25       ICOB 4.7.1 R (1)(b)
- 26       Article 12
- 27       Article 14
- 28       FSMA section 384(5)
- 29       ENF 11
- 30       ENF 12
- 31       ENF 13
- 32       Article 13, paragraph 3
- 33       FSMA section 380; see ENF 6
- 34       ICOB 1.3.4 R – 1.3.6 R
- 35       ICOB 1.3.4 R. The information that must be provided is set out in a table in ICOB 5.5.20 R and relates to choice of law and arrangements for handling complaints including, where appropriate, the existence of a complaints body
- The state of risk is: (a) if the insurance relates to a building the state in which the building is situated; (b) if the insurance relates to a vehicle, the state of registration; (c) in the case of policies of a duration of four months or less covering travel or holiday risks (whatever the class concerned), the state in which the policyholder took out the policy; (d) in a case not covered by (a) to (c), (i) if the policyholder is an individual, the state in which he has his habitual residence at the date when the

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contract is entered into; and (ii) otherwise, the state in which the establishment of the policyholder is situated at that date

<sup>36</sup> ICOB 1.3.5 R. The information that must be provided is set out in a table in ICOB 5.5.20 R

<sup>37</sup> ICOB 4.2.19 R