

dti

**CONSUMERS ESTATE AGENTS AND
REDRESS BILL**

Regulatory Impact Assessment

2006

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PROPOSALS TO IMPROVE THE REGULATION OF THE ESTATE AGENCY SECTOR

Introduction and Summary

- 3.1 This section of the Regulatory Impact Assessment assesses the costs and benefits of Government proposals to introduce compulsory redress for estate agents and to improve the regulation of the estate agency sector, which were originally set out in the Government response³¹ to the March 2004 OFT market study report on the estate agency market in England and Wales³². The proposals are aimed at dealing with the OFT findings that there is a high degree of consumer dissatisfaction with estate agency services, that consumers find it difficult to complain and obtain redress, and that enforcers are restricted in their ability to take action by limitations on their powers and the scope of the Estate Agents Act 1979 (EAA).
- 3.2 The OFT recommended that action was needed to improve estate agents' standards of customer service by improving service quality and means of redress by developing self-regulatory codes of practice. They also recommended that powers should be obtained to establish a statutory redress mechanism against the possibility that voluntary codes do not deliver improvements. As far as the EAA itself is concerned, OFT recommended some changes to make the existing regulatory regime more effective. To increase transparency there should be new documentary requirements for estate agents, including obligations to keep clear records of all offers made and copy these to both sellers and potential buyers. To facilitate enforcement, OFT and trading standards officials should be given enhanced powers to gain access to these records so it is easier for them to obtain evidence of breaches of the legislation and take enforcement action against agents who do not comply with regulatory requirements, including where justified banning unfit agents.
- 3.3 The Bill provisions will apply to those businesses that engage in estate agency work as defined by the EAA (which essentially applies to the buying and selling of residential property but not to lettings) and to both buyers and sellers.

Background

Existing regulatory regime

- 3.4 Estate agents in the UK are regulated by the EAA, which:

³¹ Government response to the OFT report on estate agents available online at <http://www.dti.gov.uk/files/file25880.pdf>

³² OFT report '*Estate agency market in England and Wales*' 2004 available online at <http://www.of.gov.uk/NR/rdonlyres/C60D0986-86B4-4A32-ACE8-41C48865693E/0/oft693.pdf>

- regulates the conduct of estate agents in the course of estate agency work, but does not cover the letting of properties;
- lays down the duties that agents owe to clients (such as the passing on of offers, handling money and giving details of charges) and to third parties (such as disclosure of personal interest); and
- gives the OFT the power to issue warning or prohibition notices against those persons they consider to be unfit to carry on estate agency work.

3.5 The Act establishes a “negative” licensing system; while estate agents do not have to obtain a licence to operate, the OFT can ban those agents they consider unfit to do so.

OFT Market Study

3.6 The OFT set out to find out if the market for estate agency services in England and Wales³³ was working well for both buyers and sellers. The OFT’s main conclusions were that:

- Although there were no obvious competition problems in relation to the structure of the market, there was evidence of a lack of price competition - consumers would benefit if they shopped around and negotiate on fees more often;
- Consumers were not happy with the services they received from estate agents and many had legitimate grievances. Some of these complaints concerned serious mischiefs that the legislation ought to deter, while others concerned quality of service issues, which could be appropriately dealt with under industry redress mechanisms if estate agents’ internal complaints procedures did not prove satisfactory;
- The EAA needed to be brought up to date and made more workable. Recommendations included: giving enforcement agencies more powers to investigate complaints and ban rogue agents; requiring estate agents to maintain written records of offers to sellers;
- extending the Act to cover new ways of buying and selling; and
- ensuring that estate agents’ contract terms and conditions were made clearer and easier to understand.

3.7 The OFT wanted the industry to improve service quality and means of redress by developing voluntary codes of practice that meet the requirements for OFT code approval under its Consumer Code Approval Scheme.

³³ Although the EAA applies to the whole UK the OFT excluded Scotland and Northern Ireland from the scope of the report – see paragraph 2.2 of the OFT report.

- 3.8 Powers should be sought to establish a statutory redress mechanism in the event that voluntary codes of practice did not deliver improvements and access to low cost redress remained low.

Rationale for Government Intervention

- 3.9 Estate agents play a central role in the housing market with over 90% of people buying and selling a home in England and Wales using an agent. In 2004 there were approximately 1.8 million house sales in England, Wales and Scotland with a total value of around £266 billion³⁴.
- 3.10 OFT's research found that 21% of sellers and 23% of buyers³⁵ reported problems with their agents. Some of these were serious problems that the legislation should deter. Less serious problems concerned service issues which do not usually warrant regulatory action by enforcement authorities or court action on the part of aggrieved consumers, but are more appropriately dealt with by estate agents' internal complaints procedures or by independent redress mechanisms. These complaints also include those complaints that are unfounded.
- 3.11 In addition to these complaints there is probably a significant number of consumers who would have complaints had they been fully aware of the actions of their estate agent. Serious issues, such as failing to pass on an offer, would not be reflected in the complaints percentages if consumers were unaware that there had been a problem.
- 3.12 The OFT identified a number of problems with the EAA which make it difficult to enforce and thus undermine its effectiveness in protecting consumers. As a result, consumers currently cannot be confident that they are adequately protected against potential abuses of their interests such as failure by estate agents to pass on offers and agents' bias towards buyers who also accept their financial services. These risks can be addressed by implementing the OFT's regulatory recommendations.
- 3.13 The Ombudsman for Estate Agents (OEA) scheme offers a free to the consumer, independent redress mechanism against the standards set out in a code of practice. In September 2005 the OEA code of practice received full OFT approval under the latter's Consumer Code Approvals Scheme. This should provide consumers with assurance that the scheme has reached high standards both in terms of its contents and its monitoring and enforcement. Since April 2006 the National Association of Estate Agents (NAEA) has required its member firms' principals, partners and directors to belong to the OEA scheme. The Royal Institution of Chartered Surveyors (RICS) does not offer an equivalent redress mechanism but it is currently piloting an ombudsman scheme in Scotland, which, if successful, will be rolled out

³⁴ HM Revenues and Customs Survey of Property Transactions in England and Wales – Tables T16.1 (England and Wales) and T16.1A (Scotland). Available on-line at:
http://www.hmrc.gov.uk/stats/survey_of_prop/menu.htm

³⁵ OFT report '*Estate Agency Market in England and Wales*' p60-1

throughout the UK. Complaints picked up by the RICS scheme are transferred to the OEA for consideration if they concern estate agency work.

- 3.14 However, only about 60% of agents currently belong to the OEA scheme. Many consumers with complaints therefore do not have the option of seeking redress through a free and independent redress mechanism. Housing markets are local so, in some areas, it is possible that consumers find it very difficult to identify any agents who belong to the scheme. Furthermore, buyers (whose rights are also protected by the OEA scheme) may be unable to exercise choice in whether to go to a scheme member, since the property they are interested in, may be marketed by an agent outside the scheme. It is also possible that many consumers are unaware of the existence of the scheme.

Consultation

- 3.15 The OFT consulted widely in preparing their report and since its publication DTI, in preparing our initial response and resulting proposals, has consulted other Government departments with an interest in estate agents – the Department for Communities and Local Government, the Department for Constitutional Affairs, HM Treasury, the Cabinet Office, the Scottish Executive, the Department for Enterprise, Trade and Industry in Northern Ireland and the Welsh Assembly Government.
- 3.16 DTI has also met with representatives of the National Association of Estate Agents, the Royal Institution of Chartered Surveyors, the Ombudsman for Estate Agents, the Office of Fair Trading, *Which?*, the Trading Standards Institute, the Local Authorities Coordinators of Regulatory Services, and the British Standards Institute. We have taken their views into account in coming forward with our proposals.

Options

- 3.17 The Government agrees that this is a market where consumers stand to benefit from increased transparency of the offer process, more effective enforcement and improvements in estate agents' service quality and access to redress. This RIA therefore considers the costs and benefits of a number of options for addressing the problems OFT identified and which the Government intends to address. The options considered here are:

Option 1: Do nothing

Option 2: Implement the OFT's regulatory recommendations to change the EAA but take no action on redress

Option 3: Implement the OFT's regulatory recommendations and encourage subscription to independent redress schemes

Option 4: Implement the OFT's regulatory recommendations and introduce a mandatory requirement for estate agents to belong to schemes that offer independent redress.

Option 5: Introduce a new "positive" licensing system and/or require estate agents to belong to industry bodies, which require adherence to approved codes of practice.

3.18 The Government propose to proceed on the basis of option 4 which will improve transparency and enforcement in this sector and guarantee consumers access to independent redress when they have a problem with an agent, while not placing onerous costs on agents or adversely affecting competition.

3.19 The Government has already taken through Parliamentary provisions in Part V of the Housing Act 2004 which enable the Secretary of State to require estate agents to belong to a redress scheme (such as an ombudsman) which will determine complaints about Home Information Packs (HIPs). The Government intends to enact the redress provisions in the Housing Act and lay an order requiring all HIP providers to belong to an approved scheme by the time HIPs are introduced on 1 June 2007.

3.20 The provisions on estate agents in this Bill will:

- extend the statutory powers for redress so that it covers consumers throughout the UK (the 2004 Act only applies to England and Wales) and enable all relevant complaints about the buying and selling of residential property to be considered by a redress scheme;
- widen the circumstances in which the OFT can issue prohibition and warning notices, for example to prohibit an estate agent from continuing to practice where he has committed, but has not necessarily been convicted of, an offence;
- require estate agents to keep certain records relating to property transactions and the requirements of the EAA; and
- give the OFT and Trading Standards Officers greater powers to inspect estate agents' records where they have a reasonable suspicion that the EAA has been infringed.

3.21 In the options just described, "Implementing the OFT's regulatory recommendations" means implementing the measures described in paragraph 3.7. The Government stated in its response to the OFT report, that it was minded to accept a number of other recommendations. Not all of these required primary legislation, such as encouraging estate agents to subscribe to Codes of Practice, and we will be consulting in due course on how estate agency contracts can be made more transparent and on whether offer letters should be copied to buyers, which can be implemented through secondary legislation. Regarding the recommendation to widen the circumstances in

which estate agents have to disclose their personal interest in property transactions, it is considered that the types of mischief of estate agents that was the target of the policy proposal will now be caught under the Unfair Commercial Practices Directive and the Fraud Bill (together with common law in Scotland relating to fraud offences). It is also considered that it is no longer necessary to address flyboarding abuses as these would also fall under the Unfair Commercial Practices Directive. Regarding the recommendation to consider redefining what constitutes acting as an estate agent, the OFT has taken steps to address the two problems which were the source of its concern at the time of report. In December 2005 the OFT issued guidance on internet property retailers setting out the types of activities carried out by them and when they are covered by the definition of 'estate agency work' contained in the EEA, which has provided some clarity on this issue. In May 2006 the OFT took action against the main practitioners of Options Contracts, obtaining statutory undertakings from him not to mislead home sellers about the service offered. These actions have helped to clarify the scope of the EEA and have sought to provide protection to consumers when dealing with new types of estate agency businesses. Therefore we have no plans to change the definition of 'estate agency work' in the EEA at present.

Devolution

- 3.22 As estate agency is a reserved matter, changes to legislation will impact agents practising in Scotland and Northern Ireland, as well as England and Wales.

Business Sectors Affected

- 3.23 The impact of costs resulting from legislative changes will fall on estate agents. According to the OFT, there are around 12,000³⁶ estate agency offices in the UK. Some of these are members of large chains or affinity groups but the majority are small businesses, typically employing around 5 people³⁷. It is estimated that around 60% of estate agents are small independent firms³⁸.

Assumptions

- 3.24 Some of the proposed new requirements, in particular the keeping of records of individual transactions, should already be commonplace within the industry; both the OEA code and that of the National Association of Estate Agents require estate agents to keep a written or computerised record of all offers they receive (including the date and time of such offers) and the client's response. So at least 60% of the industry is already likely to be complying with these requirements.

³⁶ OFT estimate – page 28, paragraph 3.43 of the OFT report

³⁷ OFT report pg 30

³⁸ Council of Mortgage Lender research quoted on page 121 of Annex C of OFT's report: Estate agency market in England and Wales - international comparisons

- 3.25 The benefits for each of the options depends on how effective each is in terms of reducing grounds for consumer complaints and making it easier (less costly) for consumers to gain redress when their cause for complaint is justified.
- 3.26 Benefits arising from implementing OFT's regulatory recommendations and ensuring all estate agents belong to redress schemes include the benefits gained from reducing the causes for complaint in the industry and making it cheaper and more effective for consumers to gain redress. Given the high level of complaints and grounds for complaint in the industry the benefits to be gained could be significant.
- 3.27 There may be significant losses in a minority of cases, particularly where sellers' homes are sold for considerably less than their real value, which could result from failures to pass on offers or declare a personal interest. We estimate there could be around 180 cases a year (a conservative estimate that only 0.01% of transactions involve significant detriment) where individual consumers lose sums of £10,000 or more: this accumulates to a total of £1.8m per annum.
- 3.28 In addition to these serious complaints we also estimate that in a market with 1.8m residential property transactions with around 22% of customers having grounds for complaint, and an average value of complaint of £50³⁹ there are maximum benefits of £20m⁴⁰ to be gained from reducing these general complaints or providing a more effective redress mechanism.
- 3.29 Overall consumer detriment totals about £21.5m per annum.
- 3.30 However, at present, roughly 16%⁴¹ of complaints yield 'satisfactory'⁴² outcomes meaning that only around £3.5m of the £21.5m consumer detriment is retrieved – leaving net detriment from unsolved complaints of approximately £18m.
- 3.31 In addition to this detriment there is also cost to consumers in terms of the time and 'stress factor' associated with obtaining redress. In a market of 1.8m property transactions, where around 22% of customers have grounds for

³⁹ £50 is a conservative estimate which disregards the minority of more serious losses and reflects that the majority of complaints are likely to be minor e.g (OFT report p63) and that most complaints were made direct to estate agents. Of the 123 cases of alleged breaches of the EAA investigated in 2002 only around 10% merited serious consideration as to the fitness of the agent (OFT report p63). A similar figure can be deduced from awards data in the 2005 OEA Annual Report (available online at: <http://www.oea.co.uk/report/report.htm>). In 2005 the OEA paid out £176,050 in awards (using medium figures based on banded information). Dividing this by the number of complaints in scope (2334) gives a figure of about £75, but this ignores complaints settled by estate agents before referral to the scheme, which would bring the figure closer to our £50 estimate.

⁴⁰ $1.8m * 22% * £50 = £19.8m$

⁴¹ Based on OFT report figures on p60 and p61 of the main report. Assumed 63% of customers (71% of sellers and 55% of buyers) who have grounds for complaint actually did so and 25% of the complaints result in consumers gaining adequate redress (an estimate based on the number of buyers' complaints handled 'satisfactorily').

⁴² These may be outcomes that the consumer is happy with rather than the 'correct outcome'. If this is the case we may be overstating consumer detriment here.

complaint and around 63%⁴³ actually do so, these costs are likely to total £2.5m if we assume the cost of complaining is £10. Making it easier to complain will reduce this.

- 3.32 Overall detriment (from consumers failing to get redress and the time they spend trying to do so) therefore totals £20.5m per annum.

Benefits

3.33 Option 1 – do nothing

- 3.34 This would leave the market unchanged and leave consumers exposed to the risk that standards will not improve and consequent potential financial detriment. It is possible that more estate agents signing up to voluntary codes would bring about improvements in standards but these will not go as far in ensuring this outcome as the other options. The overall detriment to consumers is likely to remain at approximately £21m per annum.

3.35 Option 2 – implement the OFT’s regulatory recommendations

- 3.36 The OFT recommendations we intend to implement centre on improvements in estate agents record keeping (to improve audit trails), by requiring them to keep records of individual transactions; giving enforcement agencies more powers to investigate complaints by enhancing their powers of inspection; and expand the circumstances in which the OFT can consider the fitness of estate agents and whether to take regulatory action against them, making it is easier to ban rogue agents.

- 3.37 Implementing Option 2 will lead to a number of benefits for consumers. New record keeping requirements will lead to increased transparency in property transactions and increase consumer confidence in their integrity. The establishing of clear audit trails will benefit estate agents in that it will be easier for them to defend themselves against unjustified complaints. This will also help enforcers in that it will be easier to investigate complaints. Increasing enforcement powers will make the investigation of complaints more effective and make it easier for appropriate action, including banning orders, to be taken against rogue agents.

- 3.38 It should also be easier for consumers to obtain redress. Strengthening the existing “negative” licensing scheme should reduce the number of people with grounds for complaint as, with new record keeping requirements and evidence seeking powers, it will be easier for the OFT to identify unscrupulous estate agents and ban them from practicing. If we assume that this option reduces the number of people with grounds for complaint by 10%, it should produce net benefits of about £2m per annum.

3.39 Option 3 – implement the OFT’s regulatory recommendations and encourage subscription to industry redress schemes

⁴³ Average of buyers (55%) and sellers (71%)

- 3.40 This would have the same benefits as option 2 but would also bring additional benefits in terms of increased take-up of codes of practice, reducing causes of complaints in the industry; and making it cheaper and more effective for consumers to gain redress.
- 3.41 The benefits of this option depend critically on the number of estate agents that sign up to the voluntary scheme. The decision by the NAEA to require member firms' principals, partners and directors to belong to the OEA scheme, has increased the number of estate agents in the scheme to about 60%. This, however, leaves little scope for further upward movement. Even if RICS was to require its estate agent members to join the OEA, or roll out its ombudsman scheme to the whole of the UK, redress scheme membership would be unlikely to go much above 70%, leaving a sizable minority of estate agents not signed up. But if we assume that sufficient estate agents sign up to the scheme such that the number of people with grounds for complaint fall by another 10% (compared to option 2) those with grounds who actually complain increase by 20%, the number of complaints resulting in a successful outcome increases by 40% and the costs of complaining falls (as more agents are in a redress scheme) from £10 to £8. In this case net benefit is approx. £5.8m per annum.
- 3.42 **Option 4 - implement the OFT's regulatory recommendations and introduce a mandatory requirement for estate agents to belong to schemes that offer independent redress**
- 3.43 The key difference between this option and option 3 is that all agencies are now part of a redress mechanism. If we assume that all estate agents sign up to the scheme such that the number of people with grounds for complaint fall by 40%, that 82% of consumers who have grounds for complaint actually do so, and around 88% of them obtain a successful outcome, this leads to £15.7m per annum in benefits.
- 3.44 This option integrates enforcement of the requirement to belong to a redress mechanism with the OFT's existing negative licensing enforcement powers as we would expect approved redress schemes to share information about abuses with the OFT . There is no need to introduce a new statutory regulator, or a positive licensing system with associated compliance costs, which would be burdensome and a barrier to market entry. It should also provide an incentive for agents to improve service standards and have the cumulative effect over time of making it easier for regulators to identify and weed out rogue agents.
- 3.45 The requirement to market residential properties with HIPs potentially makes the role of estate agents in the house buying process more important. It is anticipated that in practice estate agents will compile the packs on the sellers' behalf and this potentially could mean that the estate agents' role will be enhanced in that they will be expected to give advice on the implications of pack information, particularly in terms of its marketable value or what remedial actions may be necessary to increase this value. The possibility that their

advice may be deficient in some way could make it even more important that sellers (and buyers) have access to independent redress. So this option also has the advantage of being forward looking in that it anticipates the potentially enhanced role of estate agents. The HIP also provides an opportunity to give consumers information about legislative requirements and redress arrangements.

3.46 Option 5 – introduce a new “positive” licensing system and/or require estate agents to belong to approved codes of practice

3.47 In this final option almost all consumer detriment is recovered yielding net benefit to consumers of around £18.3m. This is based on the assumptions that grounds for complaints halve (since all agencies have ‘minimum standards’) and number of complaints and those that are successful reach 90%. The addition of a statutory Ombudsman is assumed to reduce complaints cost from £10 to £3 per complaint. It is important to note that the exact amount of the benefit will depend on how stringent these minimum standards are – with very heavy licensing rules very close to all consumer detriment would be recovered but the costs would be much higher.

3.48 In addition, for all options that include expanding access to redress, additional costs savings will arise for cases that would otherwise have gone to the small claims court.

Costs

3.49 Option 1 – do nothing

3.50 This option imposes no new burdens so it should not lead to increased costs.

3.51 Option 2 – implement the OFT’s regulatory recommendations

3.52 In their report, the OFT comments that these changes will not be onerous to business. We consider that this will be the case with the recommendations we plan to implement.

3.53 Requiring agents to make and keep records, including records of offer letters, will incur additional costs for some estate agents, but these are likely to be small as many estate agents already meet these recommendations as they reflect elements of trading bodies’ codes of practice. For example the OEA Code of Practice requires member agents to keep a written or computerised record of all offers you receive (including the date and time of such offers) and the client’s response. This means that at least 60% of estate agents are subject to formal record keeping requirements. In addition those estate agents that take contract and pre-contract deposits from clients must have systems for recording transactions as required by the Estate Agents (Accounts) Regulations 1981, and all estate agents are subject to record keeping requirements under the Money Laundering Regulations 2003. Following the implementation of the Third Money Laundering Directive, estate agents will also be subject to checks to ensure compliance.

- 3.54 We consider that the number of estate agents not making and keeping records of transactions to be very small, perhaps less than 5%. Estate agents are already required to pass on offer letters promptly and in writing (unless the seller has specified he doesn't want to see them) and it is an undesirable practice not to do so. Photocopying and filing offer letters, or saving e-mails where sent, requires little effort on behalf of an agent. It is also in estate agents' best interest to do so, as they would want to contact other potential buyers when an offer is withdrawn.
- 3.55 According to HMRC there were 1.8 million residential property transactions in 2004⁷. Assuming there are 5 offers for every transaction, agents would have to send 9 million offers per annum. If 5% of agents do not have record keeping systems, 450,000 records need to be copied and filed. Assuming it costs 5p to photocopy a letter, this would come to £22,500 pa. This figure does not take account of offer letters sent electronically, so the actual costs is probably much less. We assume that all estate agents have photocopying equipment and that they would not have to purchase copiers and/or scanners to do this.
- 3.56 The enforcement changes proposed should make it easier for OFT and Trading Standards departments to enforce the EAA more effectively, which will increase the effectiveness of the time enforcement officers spend dealing with investigations and associated legal costs. Overall we think the changes will be cost neutral. It is up to Trading Standards in consultation with DTI to decide on its enforcement priorities given its resources.
- 3.57 **Option 3 – implement the OFT's regulatory recommendations and encourage subscription to industry redress schemes**
- 3.58 As well as the costs outlined for option 2 above, the costs of estate agents joining voluntary codes of practice and entering into schemes that provide redress will depend on the number of agents that choose to join such schemes. At present the costs of entering the Ombudsman for Estate Agents scheme is approx. £130 p.a.⁴⁴ per branch and 60% of estate agencies are part of the scheme. There are approximately 12,000 estate agencies in the UK so this equates to a cost of £936k. If a further 20% of estate agents join the Scheme annual membership costs would be £312k and one-off joining costs £56k. Depending on the number of agents joining, membership costs may actually fall as result of economies of scale. Costs also include those associated with advertising campaigns to raise consumer awareness of redress schemes and codes of practice. Publicity costs would be born by the schemes, but also by the OFT which recently publicised the Ombudsman for Estate Agents scheme after it obtained full code approval under its Consumer Codes Approval Scheme. That one-off campaign cost about £175,000, so we would expect a similar sum to be spent on a membership campaign, but more if it was ongoing. The OEA commented that persuading non-members to sign up would be expensive, but did not provide a cost estimate

⁴⁴ £129.25 per branch, including VAT, but excluding £23.50 joining fee.

- 3.59 **Option 4 - implement the OFT's regulatory recommendations and introduce a mandatory requirement for estate agents to belong to schemes that offer independent redress**
- 3.60 Assuming that the existing Ombudsman for Estate Agents scheme applies for and gets approval to run a mandatory redress scheme, costs would fall on the 40% of estate agents currently outside the scheme. Based on existing fees, annual membership costs would be £624k and one-off joining costs £113k. Should all estate agents join the Ombudsman Scheme, we would expect membership costs to fall somewhat as a result of economies of scale. A reduction in the membership fee of £10 would reduce costs for new members by £48k to £576k. There would also be savings for existing members of £72k, leaving a net cost of about £0.5m.
- 3.61 Some consumers may face higher charges since some agents might pass on the costs of scheme fees. Requirements to join schemes could also reduce the number of estate agents entering the market and therefore reduce competition.
- 3.62 There may be increased costs for regulators in dealing with estate agents who fail to sign up to approved schemes, but we think there would be few instances of this and the regulatory costs should be offset by other changes making it easier to enforce the EAA. There could also be possible additional costs in dealing with referrals from the redress schemes for regulatory action, but these would be cases where there is strong evidence that calls the agent's fitness into question and who may already be the subject of enforcement action.
- 3.63 **Option 5 - introduce a new "positive" licensing system and/or require estate agents to belong to approved codes of practice**
- 3.64 Costs for this final option depend on the exact nature of the 'minimum standards'. If these standards include basic commitments e.g. free redress and service standards of a certain level, costs are likely to be very similar to option 4 with potential licence fees as an addition. However, where minimum standards are much tougher and, for example, estate agents need to pass a professional qualification in order to practice, costs to estate agents will be significantly higher. The exact extent of these costs would need to be estimated through consultations with industry if specific measures were put forward.
- 3.65 However, if we use the analogy with consumer credit licensing⁴⁵ which imposes a positive licensing requirement on lenders and brokers, the cost of a licence could be around £200. If we assume that all 12,000 estate agency offices need to obtain such a licence, the initial costs to the sector could be

⁴⁵ Consumer credit licences currently cost £110 for sole traders and £275 for partnerships, limited companies and other organisations. The licences must be renewed after 5 years.

£2.4 million. If agents are individually licensed, this figure could be as much as £12 million.

- 3.66 The introduction of mandatory training costs will also impose costs on estate agents. If we assume that at each branch one agent needs higher level training at a cost of £2000 this will cost £24m (for 12,000 branches) and all agents need to pass basic level training at a cost of £300 (assume five agents at each branch) gives costs of £18m. Total training costs, therefore total £42m.
- 3.67 In addition to the direct training costs we also need to consider opportunity costs i.e. the costs to estate agencies of the lost earnings when agents are on training programmes. Assuming basic training lasts 5 days and advanced training lasts 20 days and salaries are £20k and £30k respectively, overall opportunity costs are £60m⁴⁶. Adding direct training and opportunity costs the costs of a detailed professional competency programme would be £102m. If training were a one-off requirement this cost could be amortised over several years (though training would also be needed for new agents entering the market), but if training was an ongoing requirement, as proposed by organisations such as *Which?*, this would be an annual spend requirement. Many estate agents have done training and obtained industry qualifications as members of trading bodies. If such qualifications were recognised by the licensing body, the number of estate agents required to training would be reduced.
- 3.68 This positive licensing arrangement also imposes additional costs as the standards act as a barrier to entry that have the potential of reducing competition. Where competition is reduced there is the risk that consumers will end up paying higher prices. This could be particularly significant in areas where there are few agents competing to begin with.

Small Firms' Impact Test

- 3.69 It is estimated that around 60% of estate agencies are small businesses so we have identified these proposals as ones that will have an impact upon small firms. It is possible that more than 60% of the cost of the proposals would fall upon small firms if they have lower existing standards than larger firms and if they are at present disproportionately outside industry redress schemes.
- 3.70 We have contacted by phone a number of small, independent estate agencies throughout the UK. They were relaxed about the proposed changes which would impact on their business practices. For example many of them already comply with potential new record keeping requirements. Costs would increase, but they did not think these would be significant. Some agents expressed misgivings about being forced to belong to the existing Ombudsman scheme but these were because agents are not currently able to

⁴⁶ Based on there being 230 working days per year (ie 52 five day weeks minus 30 days annual leave and bank holidays).

appeal against its decisions, not because of the cost implications. However, as the OEA grew out of a scheme for corporate estate agents, we estimate that less than 60% of its current membership will consist of small independents. If we assume that only around 30% of small independents currently belong to the scheme, then the cost of another 5,000 offices signing up to redress schemes would be around £600k⁴⁷ per annum (inclusive of VAT) and one-off joining costs of £118k.

- 3.71 These proposals also need to be seen in the context of the Government's proposals to introduce HIPs, which to some extent they complement. Research carried out by the Department for Communities and Local Government on the likely impact of HIPs on small businesses found that HIPs were only part of a much more extensive change programme facing small estate agents, not least changes driven by developments in information technology such as electronic conveyancing. Estate agents will also be affected by changes to money laundering regulations and those that carry out letting by the introduction of the Tenancy Deposit Protection Scheme. The research found a strong belief among small estate agents that one of the ways they could best compete with larger corporate competitors was to concentrate on quality of service. Effective redress arrangements will help with this.

Competition Assessment

- 3.72 OFT's report considered competition in this market and found no obvious competition problems in terms of its structure. In developing our recommendations we have considered the impact of each option on competition within the market. In particular we have taken account of the fact that introduction of a positive licensing scheme (option 5) would increase barriers to market entry and hence has the potential to significantly reduce competition and ultimately result in higher prices for consumers. With this in mind we conclude that option 5 is not the most appropriate method to resolve the problems in the market identified by OFT.
- 3.73 However, we consider that options 2-4 are generally pro-competitive. For example, by improving enforcement and removing unscrupulous agents from the market 'fair' competition between agents should improve.
- 3.74 These proposals should not disproportionately affect any areas of the market, other than unscrupulous agents, and should not affect overall market size.

Compensatory Simplification Measures

- 3.75 On 15 December 2005 the Secretary of State revoked the Restriction on Agreements (Estate Agents) Order 1970. The order, which made unlawful agreements and arrangements between estate agents relating to charges, the advertising of charges and recommendation of charges, was introduced following an investigation by the Monopolies Commission that found that

⁴⁷ Assuming a membership fee of £120.

estate agents charged fees or commission at rates published by national societies or local associations, and that this restricted competition and was against the public interest. The OFT recommended revoking the order on the grounds that practices covered by the order were likely to be subject of the Competition Act 1998 and that fines for breaches of the Act are likely to be a sufficient deterrent against the use of past practices. The 2004 OFT report on estate agents in England and Wales found no structural competition problems in the market and no evidence that agreements of the type prohibited by the 1970 Order existed. While not directly linked to the redress membership or enforcement changes, the revocation of the order reduces regulation in the sector and saves estate agents (particularly those setting up) time and money in interpreting and complying with the regulation, thereby offsetting some of the additional costs associated with these changes.

Enforcement and Sanctions

- 3.76 The EAA is enforced by the OFT and local Trading Standards Departments, and this will continue to be the case.
- 3.77 Following the proposed changes the OFT will have greater scope to consider the fitness of estate agents and whether to issue banning and warning orders under sections 3 and 4 of the EAA. The OFT and Trading Standards will be able to inspect records of transactions such as offer letters and gain access to premises and demand on-site production of records when they have reasonable grounds to suspect that an agent has not complied with the EAA. Estate agents that refuse to join an approved redress scheme will face penalty charges and will ultimately be banned from engaging in estate agency work if they refuse to join one. We expect these changes to lead to more enforcement action, but targeted at agents who breach the law. As with the other proposals in the Bill, enforcement should be in line with the Hampton principles of regulatory enforcement, as set out in the Hampton Report.
- 3.78 The enforcement changes proposed should make it easier for OFT and Trading Standards departments to enforce the EAA more effectively enabling them to better spend time dealing with investigations. Consequently the effect on enforcers should be cost neutral. While there will be some one-off training costs as the OFT and Trading Standards train their staff in the new regulations, with suitable forward planning some, or all of this, can take place as part of routine staff training.

Compliance and Monitoring

- 3.79 All estate agents will be required to belong an authorised redress scheme and comply with the regulatory changes to the EAA.
- 3.80 Compliance of redress scheme membership is expected to be very high as failure to belong to a redress scheme could result in estate agents being banned from practising. We expect Trading Standards to monitor membership of redress schemes in conjunction with checks on HIPs usage.

3.81 We also expect compliance with the regulatory changes to be high as they are designed to make it easier for enforcers to identify rogue agents and drive them from the market.

Post Implementation Review

3.82 There is a risk that our proposed approach of updating the legislation and requiring estate agents to belong to redress mechanisms will not result in the desired reduction in consumers having grounds for complaint or improvements in estate agency practices. We therefore propose to review the impact of these changes in a few years and will be undertaking some work in the future to establish a baseline against which the effectiveness of the action plan can be measured.

Summary and Recommendation

Option	Benefits and Potential to achieve objective	Costs and Risks
1. Do nothing	<p>Benefits: None</p> <p>Potential to achieve objective: The industry is already pursuing a number of initiatives, which should encourage agents to join suitable schemes. The OEA code of practice has received full approval under the OFT's Consumer Code Approvals Scheme and the RICS is piloting an ombudsman scheme of its own. The NAEA now requires member firms' principals, partners and directors to belong to the OEA. These have led to an increase in membership of schemes offering free and independent redress resulting in about 60% of all agents belonging to schemes.</p>	Costs: None
2. Implement the OFT's regulatory recommendations to	<p>Benefits: £2m p.a.</p> <p>Potential to achieve</p>	Costs: Up to £22,500 p.a.

<p>change the EAA but take no action on redress.</p>	<p>objective: Should make it easier for OFT and Trading Standards departments to enforce the EAA more effectively and lead to less complaints from consumers. Targets action on rogue agents.</p>	
<p>3. Implement the OFT's regulatory recommendations and encourage subscription to independent redress schemes.</p>	<p>Benefits: Up to £5.8m p.a.</p> <p>Potential to achieve objective: As above, but ancillary actions such as consumer education publicity campaign, changes in agents' marketing practices and role of trade bodies should encourage estate agents to sign up to codes of practice.</p>	<p>Costs: Up to £0.312m p.a.</p> <p>Risks: As above.</p>
<p>4. Implement the OFT's regulatory recommendations and introduce a mandatory requirement for estate agents to belong to schemes that offer independent redress.</p> <p>Powers in the Housing Act 2004 enable the Government to require estate agents in England and Wales to belong to redress schemes. But as these schemes can only consider complaints about HIPs, the Government will need to introduce additional legislation to extend their scope to all types of consumer complaints about the buying and selling of residential</p>	<p>Benefits: Up to £15.7m p.a</p> <p>Potential to achieve objective: As option 2, but will also ensure 100% of consumers have access to independent redress. This should also provide an incentive for estate agents to improve service standards, make it easier for regulators to identify poorer agents and take remedial action, including where appropriate banning unfit agents.</p> <p>This will also reflect the introduction of Home Information Packs (HIPs), which potentially make the role of the estate agent more</p>	<p>Costs: £0.5m p.a.</p>

property, and those in Scotland and Northern Ireland.	crucial and increase the importance of consumers having access to redress when things go wrong.	
<p>5. Introduce a new “positive” licensing system and/or require estate agents to belong to approved codes of practice.</p> <p><i>Which?</i> has called for a system that would feature a new regulator, licensing, a mandatory code of practice and competence requirements.</p>	<p>Benefits: Up to £18.3m p.a.</p> <p>Potential to achieve objective: As option 2, but upfront licensing tests may also prevent some unfit people from starting in business in the first place.</p> <p>Will ensure 100% of consumers have access to independent redress.</p>	<p>Costs: £2.4 - 12m p.a (where ongoing training is required these costs will increase by up to £102m p.a.)</p>

3.83 Option 4 is recommended because it provides a targeted, proportionate approach, which has the potential to improve standards considerably in this sector without imposing unnecessary costs on the industry, and also addresses potential changes in the role of estate agents as a result of the introduction of HIPs.

Contact

Any comments on this section of the Regulatory Impact assessment should be addressed to:

Graham Noyce,
Consumer and Competition Policy Directorate,
Department of Trade and Industry,
V413, 1 Victoria Street,
London SW1H 0ET
Tel: 020 7215 2135
E-mail: graham.noyce@dti.gsi.gov.uk

DECLARATION

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

*Ian McCartney, Minister of State for Trade, Investment and Foreign Affairs,
Department of Trade and Industry*

End
DTI
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