EXPLANATORY MEMORANDUM TO

THE HOME INFORMATION PACK (REDRESS SCHEME) ORDER 2007

2007 No. 560

1. This explanatory memorandum has been prepared by the Department of Trade and Industry and is laid before Parliament by Command of Her Majesty.

This memorandum contains information for the Joint Committee on Statutory Instruments.

2. Description

The Order requires estate agents in England and Wales to belong to an approved redress scheme that will deal with complaints related to Home Information Packs (HIPs). The requirement to belong to an approved redress scheme will only apply to estate agents that undertake 'estate agency work' as this term is defined in the Estate Agents Act 1979.

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

None.

4. Legislative Background

Section 172(1) of the Housing Act 2004 (the Act) provides that the Secretary of State may make an Order requiring every estate agent in England and Wales to be a member of an approved redress scheme for the purpose of HIP–related complaints. Section 172(4) provides that an order may exclude estate agents of a prescribed description from the duty to join such a scheme.

5. Territorial Extent and Application

This instrument applies to England and Wales.

6. European Convention on Human Rights

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

7. Policy background

7.1 Under section 155 of the Act, with effect from 1st June 2007 every person who markets residential property in England and Wales will be required to provide a HIP in relation to that property. In the majority of cases the person marketing the property will be an estate agent, and under section

172 of the Act they may be required to belong to a redress scheme, under which complaints relating to HIPs can be referred to an ombudsman.

7.2 Section 172(3) of the Act provides that before making the Order, the Secretary of State must be satisfied that he has approved a redress scheme (pursuant to section 173 of the Act). The Secretary of State has approved a scheme for this purpose to be run by the Ombudsman for Estate Agents and details of the scheme are available on the DTI website.

7.3 The Act provides that an Order may exclude estate agents of a prescribed description from the duty to belong to an approved scheme or limit any duty so that it only applies in relation to relevant complaints of a prescribed description (section 172(3)). The Order makes it clear that only estate agents who are doing estate agency work as defined in section 1 of the Estate Agents Act 1979 will be required to join a redress scheme. This will mean that those who are excluded from the 1979 Act, such as solicitors who might also market properties as part of their business, will not have to join a redress scheme, as they are already subject to controls at least as rigorous as those that will be imposed on estate agents.

7.4 Section 172(2) states that acting in contravention of the Order will be regarded as a breach of duty under Part 5 of the Act. Breach of the duty to belong to an approved scheme will be punishable by a penalty charge notice issued by a local Trading Standards Officer (up to a maximum of £500) (section 168(1)(b)). In addition, section 175(3) states that this breach will be regarded as if it were an undesirable practice under section 3(1)(d) of the Estate Agents Act 1979. This means that the OFT will be able to consider the fitness of an agent to practise, and ultimately ban an agent if he is deemed to be unfit.

7.5 This Order will ensure that sellers and potential buyers of residential property in England and Wales have access to free independent redress for complaints against estate agents, which relate to HIPs.

7.6 Hansard references to the provisions in this Order: 14/06/06 – Off. Report - c58-60WS and c17-9WS; 22/07/04 – Off. Report – cWS61; 13/09/04 - Off. Report - 1004; 16/09/04 – Off. Report – c1295-7; 19/10/04 – Off. Report – c689-90, 692 and 706; 20/10/04 – Off. Report - 880; 08/11/04 – Off. Report – c646; 18/11/05 – Off. Report - c1352-4; 30/03/06 – Off. Report - c144WA; 10/01/07 - Off. Report - c99GC.

8. Impact

A Regulatory Impact Assessment is attached to this memorandum.

9. Contact

Natasha Chopra at the Department of Trade and Industry: Tel: 020 7215 1106 or e-mail: Natasha.Chopra@dti.gsi.gov.uk can answer any queries regarding the instrument.

dti

Home Information Pack (Redress Scheme) Order 2007

Regulatory Impact Assessment

2007

URN 07/705

1) Summary

Under the Home Information Pack (Redress Scheme) Order 2007, benefits are expected to range from £0.7m to £2.9m and costs are expected to be £515,000, giving an overall net benefit of £185,000 to £2,385,000.

2) Purpose and intended effect of the Order

i) Objective

To ensure consumers have free independent redress for Home Information Packs (HIPs) related complaints against estate agents by requiring estate agents in England and Wales[1] to join a Government-approved redress scheme by 1 June when HIPs are introduced.

ii) Background

The OFT report on the estate agency market in England and Wales (2004) recommended that estate agents should voluntarily belong to a redress scheme. The Government in its response to the OFT report decided to go further by making membership of a redress scheme compulsory for estate agents. The Housing Act 2004 was going through Parliament and so the Government tabled an amendment, allowing this aim to be partially met – the scope of the Bill only enabled requiring estate agents in England and Wales to belong to an approved redress scheme for HIP-related complaints. The Consumers, Estate Agents and Redress Bill (CEAR Bill), which is currently going through Parliament will enable the Government to fully meet its aim, by requiring all estate agents in the UK to belong to an approved redress scheme for all complaints related to residential buying and selling.

Looking specifically at the redress measures in the 2004 Act, the enabling power to make an order requiring estate agents to belong to an approved redress scheme was included in section 172(1). Under the 2004 Act, where properties are marketed through an estate agent, the estate agent will have to ensure that a HIP is assembled when marketing starts and that the documents contained in the HIP are authentic and complete. This duty comes into force on 1 June 2007. As a result of this Order, consumers will have access to independent redress should the estate agent fall short of any aspect of their duties as laid out in Home Information Pack legislation.

iii) Rationale for Government intervention

From 1 June 2007, home sellers in England and Wales will be required to provide a HIP when they place their home on the market. This Order will, by requiring estate agents to belong to an approved redress scheme, ensure consumers have free access to redress for HIP-related complaints against estate agents.

[1] Section 150 of the Housing Act states that "A person acts as estate agent for the seller of a residential property if he does anything, in the course of a business in England and Wales, in pursuance of marketing instructions from the seller." It further states that "business in England and Wales" means a business carried on (in whole or in part) from a place in England and Wales.

Within the current voluntary scheme, Ombudsman for Estate Agents (OEA) state that many of the complaints they receive cannot be investigated by them as the agent is not a member of their scheme. It is probable that those agents about whom there are more likely to be complaints would be less likely to voluntarily join a redress scheme, and so making it compulsory is the only way to ensure full consumer redress for complaints against estate agents related to HIPs.

For a risk assessment of what would happen without Government intervention, please refer to the 'Do nothing' option below.

I. Options

Option 1) Do nothing

It is intended that the CEAR Bill's estate agents provisions will come into force in April 2008, which would make it mandatory for all estate agents to belong to a redress scheme including redress on HIPs from that date. Conditional on this Bill coming into force on the date prescribed and in the form currently envisaged, the current do nothing scenario would only see the provisions delayed for a period of 10 months. Currently around 34% of estate agency businesses in England and Wales out of the total number of 11,000 do not belong to the voluntary redress scheme, and if we assume that this figure remained constant until April 2008, this represents the number of estate agency businesses against which consumers would not be able to get redress on HIPs until April 2008 under this do nothing scenario.

Option 2) Implement redress provisions in the Housing Act, to provide access to independent redress for consumers with complaints against estate agents related to HIPs.

Option 3) encourage consumers to use an estate agent that belongs to a voluntary ombudsman scheme for estate agents

This option has not been analysed as we do not believe that increasing consumer awareness of the voluntary ombudsman scheme would significantly increase membership of the scheme, particularly in the short-run. This is because it would be difficult to imagine consumers making membership of an ombudsman scheme a significant factor in buying and selling decisions in the residential housing market. This is particularly true for buyers, who by tending to choose properties rather than agents[2], will be unable to create an incentive for agents to improve their service for instance by joining a redress scheme. However, sellers might also be expected to bring little pressure to bear, with their primary focus targeted on the net return they receive on the sale of their property.[3]

[2] Draws on analysis from Office of Fair Trading 'Estate agency market in England and Wales' para 7.18, pg 104
[3] Ibid, para 1.11, pg 3

II. Benefits

The Order will have the effect of improving consumer protection, ensuring redress for complaints against all estate agents, which relate to HIPs. Were this Order not to be made, consumers would not have access to redress for HIPs-complaints against the 34% of agents that do not belong to the OEA's current Sales scheme until April 2008, beyond seeking redress through the courts, at quite high financial costs.

At present, as the HIP scheme is not up and running, it is not known with certainty the issues that the HIPs redress scheme will be required to address. For instance, we expect the legislation to provide sellers and buyers with a statutory option for redress should the compilation of the HIP by an estate agent be done incorrectly. However this would not extend to the quality of the professional advice contained in documents provided as part of the HIP, as the estate agent cannot be expected to assess quality where this is out of their professional competency. Additionally, redress could be available should the estate agent fail to advise the seller that a HIP is required. In each case complainants should first address their complaint to the individual, company or organisation concerned but if they are unable to obtain a satisfactory outcome appeal to the ombudsman provides a route for redress for complaints against estate agents.

In terms of calculating benefits, this analysis utilises the same economic analysis that was undertaken for the CEAR Bill Regulatory Impact Assessment (RIA). This is based on comparing the results from option 1 of that RIA, which is the do nothing option, with option 4 which required all estate agents to belong to schemes that belong to independent redress schemes.[4]

[4] Option 4 within the Consumers Estate Agents and Redress Bill Regulatory Impact Assessment relates to redress on all estate agents activities and not only limited to HIPs as this RIA relates to.

In order to calculate the consumer benefit from the movement to mandatory redress, ignoring any impacts on changes to the cost of consumer complaints initially, three factors are required to make this calculation.

a) The number of cases in which consumers are expected to have a valid ground for complaint against estate agents in regard to HIPs.

This actually appears to be the most difficult of the three questions to answer as HIPs are currently not launched. The CEAR Bill RIA estimated that in a market of approximately 1.6m residential property transactions[5], 22% of customers had grounds for any type of complaint.[6] Therefore in the absence of any further information, this analysis has used this as a guide to setting the number of complaints that could be expected in relation to HIPs. As HIPs are only one aspect over which consumers could make a complaint about the activities of estate agents, the number of justified complaints in relation to HIPs can be expected to be considerably beneath the 22% figure for any type of complaint. Due to the great uncertainty with regard to the number of HIP complaints expected, the analysis considers three separate levels for the number of consumers with justified grounds for a complaint: 5%, 2.5% and 1.25%.

b) In the CEAR Bill RIA, the analysis assumes that the movement to a mandatory redress scheme has three impacts in regard to consumer detriment; the grounds for complaint fall, the

[5] No. of residential property transactions carried out in England and Wales.
[6] Average of % of buyers and sellers identified by OFT survey as having grounds for legitimate complaint against the practices of an estate agent. The Office of Fair Trading 'Estate agency market in England and Wales' para 1.16, pg 4.

number of consumers who actually complain rises and the number of successful complaints rises. Thus in the do nothing scenario, 18.5% continue to suffer consumer detriment in spite of the existence of the voluntary redress scheme, with only 3.5% of consumers receiving recompense (figures add up to the 22% that suffer detriment initially).[7] Under the mandatory redress option, only 3.6% of consumers continue to experience consumer detriment in the wake of the redress system.[8] These figures imply that the level of consumer detriment experienced under the do-nothing option is just over 5 times greater than that experienced under a mandatory redress scheme[9] and it is this figure which has been utilised in this analysis.

c) Consumer detriment in the CEAR Bill RIA was assumed to be £50[10] in the case of the 22% of cases where consumers were thought to have grounds for complaint[11]. This analysis sticks with the £50 assumption for the cost of unredressed consumer detriment.

[7] 22% are estimated to have a ground for complaint, 63% of these are estimated to actually complain with only 25% of these actually getting a satisfactory outcome. Calculation for those still subject to consumer detriment is:- 0.22*(1-(0.63*0.25))=0.185=18.5%

[8] 13% of consumers are estimated to have a ground for complaint, 82% are estimated to actually complain with 88% of these actually expected to get a satisfactory outcome. Calculation for those still subject to consumer detriment is: - 0.13*(1-(0.82*0.88))=0.036=3.6%

[9] Full calculation 0.1835/0.036192=5.07

[10] Based on information from both the OFT market study report and the 2005 OEA Annual Report.

[11] This ignores the small number (estimated at 0.01%) of cases where significant consumer detriment (>£10,000) is thought to occur to consumers from transactions in the housing market. However this has not been included in the

% of customers with ground for HIPS complaint	Total number of consumers with ground for HIP complaint	Consumer Detriment remaining after redress under the current voluntary scheme[12]	Consumer Detriment remaining after redress in the mandatory scheme[13]	Consumer Benefit from mandatory HIPs
5%	80,000	£3.4m	£0.7m	£2.7m
2.5%	40,000	£1.7m	£0.3m	£1.4m
1.25%	20,000	£0.9m	£0.2m	£0.7m

The benefit from the mandatory provision of HIPs redress in terms of reducing consumer detriment is estimated as being between £0.7m-£2.7m, with the expected benefit expected to be higher the greater the number of legitimate complaints consumers have in regard to estate agents' HIPs service.

In addition, the CEAR Bill RIA additionally estimated that the cost of complaining would fall if a mandatory scheme was bought in with the cost falling from £10 to £8, due to the fact that more

analysis here as complaints in relation to HIPs are not expected to produce significant levels of detriment in relation to the activities that estate agents are responsible for.

[12] Calculation: - No. of Cases* (1-(0.63*0.25)*50.

[13] Consumer detriment remaining under the voluntary scheme/5.07 (see footnote 9 for details of denominator)

agents were inside a redress scheme.[14] Again the benefit of bringing the scheme in on a mandatory form would vary according to the number of complaints received with the estimate that it could add between £0.05-£0.2m of additional consumer benefits due to the lower total cost of complaints, with the high estimate resulting if 5% of consumers initially had grounds for complaints under HIPs, and the low if it was only 1.25%.

Thus the total range for estimated consumer benefits from the imposition of the mandatory scheme in June 2007, is £0.7-£2.9m per annum.

Costs

The OEA is the only organisation to have received Government approval of their HIPs redress scheme under the Housing Act. [No other applications have been received.] Currently around 66% of estate agent offices (out of 11,000 estate agency businesses in England and Wales) voluntarily belong to the Ombudsman for Estate Agents (OEA) scheme for which they pay a fee of £130 per annum plus VAT. This provides free independent redress to consumers for complaints against their member agents, on any aspect of home buying and selling. Current members of the OEA's wider scheme will automatically become members of the HIPs scheme and will therefore not face additional membership costs. The 34% of estate agency businesses outside the OEA's wider scheme will need to join the approved HIPs scheme. Annual membership costs will be £100 plus VAT, for each branch of the business that is sited in England and Wales, which would represent a total cost to the industry of £374,000 plus VAT. In

[14] CEAR Bill RIA 2006 – para 3.41. page 49.

addition OEA will require members to have Professional Indemnity Insurance (PII) of £100,000, meaning that those agents not part of the voluntary scheme and with PII currently below this amount (likely to be very few as estate agent trade bodies say that it is generally accepted standard practice to have this in place and all professional bodies in the sector require this level of PII) will bear an additional cost. The NAEA have estimated that the cost for a start-up company in the industry of obtaining PII cover of £100,000 is £250.[15] However fees for a more established business are likely to vary according to the amount of business they conduct, the geographical location of the business, the management structure in place, the type of business they conduct and the level of past claims amongst other factors, so that premiums will vary across different agents. In this analysis we have used the £250 figure as the cost per branch of obtaining PII cover of £100,000[16] with informal consultation with NAEA indicating that this figure could be used as a proxy for the cost of PII cover on a branch basis[17]. Despite the evidence from the trade body that very few estate agents are likely to need to purchase additional PII cover to comply with membership, we have taken a very conservative approach and assumed that 5% out of the total of all estate agency branches will need to meet the additional expense. This equates to 550 estate agencies, with an associated total cost therefore of £137,500 plus VAT.

Consumers will not be charged for using the approved redress scheme – one of the Department of Trade and Industry's criteria to approve a HIPs redress scheme is that it must be free to consumers.

Adding up all the additional costs associated with the mandatory scheme produces a total cost of £515,000 plus VAT per annum.

[15] This figure is based on PII cover of £100k, for an estate agency business generating £50,000 gross fees based purely on estate agency business.
[16] This takes account of the fact that established companies are likely to conduct more business and hence be subject to higher premiums, but on the flip side larger firms are likely on average to have better management structures in place to manage risk.
[17] In reality PII will be taken out by the whole estate agency business as opposed to by each individual branch.

Equity & Fairness

Under this order, all consumers buying or selling a home in England and Wales will have free access to redress for HIP-related complaints against estate agents.

The Small Firms Impact Test

Research has been undertaken with a number of estate agents, conveyancers and surveyors to test the potential impact on small businesses of HIPs and associated reforms, including redress arrangements. Small businesses were divided in their views on the likely impact of the Government's proposed reforms. Those businesses that were opposed to the reforms were also the most concerned about the potential for HIPs to have a negative effect on their business. Those that supported the reforms tended to see it as an opportunity to increase their business in the sector.

Costs of belonging to the redress scheme are on a per office basis and will therefore not have a disproportionate impact upon small estate agency businesses which have comparatively few branches. In addition, the costs per estate agent of belonging to the redress scheme are small compared to their overall turnover at £100 per estate agency branch, so it is not expected to have a discernable impact on the industry. In addition, the cost of PII cover is packaged according to the level of fees received by an estate agency business, at least at the smaller level of fee levels, so smaller firms will pay a smaller premium for the same level of PII as compared to a larger firm. Finally, the cost of this particular provision can be placed in the context of the Government's overall policy proposals to introduce HIPs, which this complements. The RIA that accompanied the publication of the Home Information Pack Regulations 2006[18] found that the one-off cost to estate agencies of training their staff in the new home buying and selling process will be around £5,000 per office. From this perspective, the additional costs imposed on some estate agents through an approved redress scheme is a minimal add-on.

Competition Assessment

Within the England and Wales estate agent market, as the measure will ensure that all estate agents conducting a business (wholly or in part) in England and Wales in future belong to an approved redress scheme, the measure actually serves to create a level playing field.

Across all providers of HIPs, as the requirement applies only to estate agents the legislation does create a potentially uneven provision across different groups of HIP providers. However the cost of £100 per estate agency branch is small in relation to the overall turnover of these businesses, so it is not expected to have any discernable effect on competition. This argument additionally applies to the cost of acquiring sufficient PII cover.

[18] http://www.opsi.gov.uk/si/em2006/uksiem_20061503_en.pdf

Potentially the larger impact upon competition could arise from the fact that estate agents will have to pay compensation to buyers and sellers if the ombudsman upholds a complaint against them with regard to their delivery of HIPs to buyers and sellers. Again a non-estate agent outside a redress system would not be faced with costs in meeting consumer redress, except where a claimant decided to pursue the case through the courts. However once again we expect the costs associated to be small. This assessment is based on analysis from the CEAR Bill RIA, which estimates that the average cost to estate agents of settling complaints is £50.[19] [20] This figure applies across all complaints received by the ombudsman, and as complaints received in regard to HIPs are expected to be relatively minor in nature and perhaps not as frequent as more general complaints of estate agency practice, it is expected that HIPs redress will add little to the overall costs of estate agents.

As some non estate agent suppliers of HIPs will be members of their own voluntary redress scheme, some non-estate agency providers of HIPS will in any event not potentially experience the small cost advantages that have been highlighted above.

Enforcement & Sanctions

The HIP duties will be enforced by local authority trading standards and OFT officers, who have similar, complementary, responsibilities under the Estate Agents Act 1979 and Property Misdescriptions Act 1991. For further information, see the RIA for the Home Information Pack Regulations 2006[21]. This means that the additional costs on local authorities are relatively small (the original bid was for an additional £2.2 million per annum) and have been included in the local government settlement. The Department for Communities and Local Government (DCLG) will meet the additional costs incurred by enforcement authorities.

Specifically on the issue of estate agents not complying with the legal duty to belong to an approved redress scheme, local trading standards officers will be able to issue fixed penalty charge notices (of up to £200) for each instance of non-compliance and where they do so will be required to inform the Office of Fair Trading (OFT) of this breach of the agent's legal duty. Under the Housing Act, if an estate agent does not comply with the legal duty to belong to an approved redress scheme whilst marketing with HIPs, it will be regarded as though it was an undesirable practice under the Estate Agents Act 1979. This means that the OFT will be able to exercise its powers to determine whether that agent is unfit to carry on estate agency work and make a Prohibition Order, banning them from practising as an estate agent.

Consultation

Within Government

[19] This takes account of cases that are sent to the ombudsman as well as making an allowance to include cases which are settled by estate agents without them entering the redress scheme system.
[20] National Association of Estate Agents report that PII would operate with an usual excess of around £1,000. This would mean that the vast majority of awards made against an agent by the ombudsman would need to be paid separately by the agent.
[21] http://www.opsi.gov.uk/si/em2006/uksiem_20061503_en.pdf

The redress measure in the Housing Act was added as a Government amendment during the passage of the Bill in Parliament, following clearance from relevant Government departments.

Public Consultation

The OFT consulted widely with stakeholders in putting together its report on the estate agency market in England and Wales (2004) which recommended that estate agents should voluntarily belong to a redress scheme. The Government's response to the OFT report said that the Government intended to make membership of a redress scheme compulsory for estate agents. The Government has continued to talk to stakeholders in the estate agency market since the OFT's report was published.

Post implementation review

The CEAR Bill provisions are expected to come into force in April 2008, including the requirement for all estate agents in the UK to belong to an OFT-approved redress scheme for complaints related to home buying and selling, including those related to HIPs. When these provisions come into force, this Order will be revoked so that agents will only need to comply with the duty to belong to an approved redress scheme under the CEAR Bill, making a review focussed on this policy impact unnecessary. In addition, a series of monitoring and evaluation exercises will be conducted subsequent to the implementation of the Home Information Pack regulations on 1 June 2007. These are intended to measure the impact of Home Information Packs against a series of key performance indicators, which includes awareness of and satisfaction with the relevant consumer redress schemes.

Declaration:

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

Signed by the Minister responsible

Ian McCartney
(Minister for Trade, Investment & Foreign Affairs)

Date *24th February 2007*

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