

Summary: Intervention & Options

Department /Agency: HM Treasury	Title: Impact Assessment of regulating the sale and rent back market	
Stage: Legislation	Version: Final	Date: 1 June 2009
Related Publications: Regulating the sale and rent back market: summary of responses to consultation, <i>HM Treasury</i> , June 2009 Regulating the sale and rent back market: a consultation, <i>HM Treasury</i> , February 2009		

Available to view or download at: <http://www.hm-treasury.gov.uk>

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What is the problem under consideration? Why is government intervention necessary?

The sale and rent back market offers some homeowners the option of selling properties at discounted rates in exchange for tenancy arrangements, typically with limited security of tenure. There is a large amount of risk involved, often borne by vulnerable consumers in pressured circumstances.

An asymmetry of information between consumers and sale and rent back providers has caused market failure. This information asymmetry can manifest itself through a lack of transparency in information provided by the sale and rent back provider, leading to consumers being unaware of, or unable to make a good assessment of the costs and benefits of the sale and rent back agreement.

Relevant existing regulations and legislation do not seem to address the full extent of potential costs to consumers. The Office of Fair Trading (OFT) has conducted a formal market study of this market, and in publishing its findings recommended FSA regulation of this market.

What are the policy objectives and the intended effects?

The policy objective is to ensure appropriate consumer protections in the sale and rent back market. The intention is increase the transparency of information provided by sale and rent back providers, reduce the potential for consumers to enter into unsuitable arrangements, and increase product quality by driving providers to improve or exit the market. Effective regulation may also facilitate the operation of competitive forces through increased transparency and potential entry of new providers previously discouraged by reputational risk.

What policy options have been considered? Please justify any preferred option.

The Government has consulted on the following options:

- maintaining existing framework;
- self-regulation; and
- statutory regulation by the Financial Services Authority (FSA), as recommended by the OFT.

The Government intends to proceed with the third option, and legislate to extend the scope of FSA regulation to include sale and rent back agreements. The costs and benefits of each option, insofar as it has been possible to ascertain these, are set out in the relevant sections below.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The Government keeps all legislation under review, and in line with good practice would expect to review the policy within three years.

Ministerial Sign-off For Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:

Date: 1 June 2009

Ian Pearson

Summary: Analysis & Evidence

Policy Option: 1. Maintain existing framework	Description: Continue to enforce existing regulatory regimes where applicable, and take no further action to improve consumer protection
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' Costs to consumers of foregone equity in selling their property at less than fair value. The negative figure at the lower end of the range indicates a potential benefit (which would be the case if the majority of consumers received more than fair value).
	One-off (Transition)	Yrs	
	£ N/A	0	
	Average Annual Cost (excluding one-off)		
	£ -6.9m to 83.7m	10	
Total Cost (PV)			£ -59.4m to 720.5m
Other key non-monetised costs by 'main affected groups' Costs incurred by consumers during the tenancy period of the sale and rent back agreement. Costs incurred as a result of ongoing negative reputation of the market.			

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' N/A
	One-off	Yrs	
	£ N/A	0	
	Average Annual Benefit (excluding one-off)		
	£ N/A		
Total Benefit (PV)			£ N/A
Other key non-monetised benefits by 'main affected groups' N/A			

Key Assumptions/Sensitivities/Risks:
 Assumes 5,000 sale and rent back agreements entered into per year.

Price Base Year 2008	Time Period Years 10	Net Benefit Range (NPV) £ -720.5m to 59.4m	NET BENEFIT (NPV Best estimate) £ -720.5m to 0
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What is the geographic coverage of the policy/option?				UK
On what date will the policy be implemented?				N/A
Which organisation(s) will enforce the policy?				N/A
What is the total annual cost of enforcement for these organisations?				N/A
Does enforcement comply with Hampton principles?				N/A
Will implementation go beyond minimum EU requirements?				No
What is the value of the proposed offsetting measure per year?				N/A
What is the value of changes in greenhouse gas emissions?				N/A
Will the proposal have a significant impact on competition?				No
Annual cost (£-£) per organisation (excluding one-off)	Micro N/A	Small N/A	Medium N/A	Large N/A
Are any of these organisations exempt?	N/A	N/A	N/A	N/A

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of	£ N/A	Decrease of	£ N/A
Net Impact			£ N/A

Key: Annual (Net) Present Value

Summary: Analysis & Evidence

Policy Option: 2. Self-regulation	Description: Encourage the development by industry of one or more voluntary codes of self-regulation
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' N/A		
	One-off (Transition)	Yrs			
	£ Unknown	0			
	Average Annual Cost (excluding one-off)				
	£ Unknown			Total Cost (PV)	£ Unknown
Other key non-monetised costs by 'main affected groups' Potential compliance costs to providers. Costs incurred by consumers during the tenancy period of sale and rent back agreement.					

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' N/A		
	One-off	Yrs			
	£ Unknown	0			
	Average Annual Benefit (excluding one-off)				
	£ Unknown			Total Benefit (PV)	£ Unknown
Other key non-monetised benefits by 'main affected groups' Potentially reduced costs (relative to option 1) to consumers of foregone equity; reputational benefits for providers.					

Key Assumptions/Sensitivities/Risks

Price Base Year 2008	Time Period Years 10	Net Benefit Range (NPV) £ Unknown	NET BENEFIT (NPV Best estimate) £ Unknown
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	Unknown				
Which organisation(s) will enforce the policy?	Industry trade bodies				
What is the total annual cost of enforcement for these organisations?	Unknown				
Does enforcement comply with Hampton principles?	N/A				
Will implementation go beyond minimum EU requirements?	N/A				
What is the value of the proposed offsetting measure per year?	N/A				
What is the value of changes in greenhouse gas emissions?	N/A				
Will the proposal have a significant impact on competition?	Yes				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border: none;"> <tr> <td style="width: 25%; text-align: center;">Micro Unknown</td> <td style="width: 25%; text-align: center;">Small Unknown</td> <td style="width: 25%; text-align: center;">Medium Unknown</td> <td style="width: 25%; text-align: center;">Large Unknown</td> </tr> </table>	Micro Unknown	Small Unknown	Medium Unknown	Large Unknown
Micro Unknown	Small Unknown	Medium Unknown	Large Unknown		
Are any of these organisations exempt?	<table style="width: 100%; border: none;"> <tr> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> </tr> </table>	N/A	N/A	N/A	N/A
N/A	N/A	N/A	N/A		

Impact on Admin Burdens Baseline (2005 Prices)			(Increase - Decrease)
Increase of	£ Unknown	Decrease of	£ Unknown
		Net Impact	£ Unknown

Key: Annual costs (Net) Present Value

Summary: Analysis & Evidence

Policy Option: 3. FSA regulation	Description: Extend the scope of Financial Services Authority regulation to cover the sale and rent back market
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COSTS	ANNUAL COSTS		Description and scale of key monetised costs by 'main affected groups' Costs to providers of regulation (one-off £8m; ongoing £20.1m); costs to providers of offering consumers a fair value sale (ongoing -£6.9m to £83.7m)*; costs to Government of regulation (one-off £90,000; ongoing £10,000).		
	One-off (Transition)	Yrs			
	£ 8.1m	1			
	Average Annual Cost (excluding one-off)				
	£ 13.2m to 103.8m	10		Total Cost (PV)	£ 113.6m to 893.5m
Other key non-monetised costs by 'main affected groups' Costs to Government of impact on work of advice centres.					

BENEFITS	ANNUAL BENEFITS		Description and scale of key monetised benefits by 'main affected groups' Reduced costs to consumers of foregone equity (relative to option 1) as a result of receiving a 'fair' price for the sale of their property*.		
	One-off	Yrs			
	£ N/A	0			
	Average Annual Benefit (excluding one-off)				
	£ -6.9m to 167.4m	10		Total Benefit (PV)	£ -59.4m to 1440.9m
Other key non-monetised benefits by 'main affected groups' Reduction of costs incurred during the tenancy period of the sale and rent back agreement.					

Key Assumptions/Sensitivities/Risks

Assumes 5,000 sale and rent back agreements entered into per year.

*Costs and benefits are relative to those set out in option 1 and discussed in the evidence base.

Price Base Year 2008	Time Period Years 10	Net Benefit Range (NPV) £ -952.9m to 1327.3m	NET BENEFIT (NPV Best estimate) £ 547.4m to 1327.3m
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What is the geographic coverage of the policy/option?					UK
On what date will the policy be implemented?					July 2009
Which organisation(s) will enforce the policy?					FSA
What is the total annual cost of enforcement for these organisations?					£ 80,000
Does enforcement comply with Hampton principles?					Yes
Will implementation go beyond minimum EU requirements?					No
What is the value of the proposed offsetting measure per year?					N/A
What is the value of changes in greenhouse gas emissions?					N/A
Will the proposal have a significant impact on competition?					Yes
Annual cost (£-£) per organisation (excluding one-off)		Micro £2000	Small £2000	Medium £13000	Large £13000
Are any of these organisations exempt?		No	No	No	No

Impact on Admin Burdens Baseline (2005 Prices)

(Increase - Decrease)

Increase of £ Unknown Decrease of £ Unknown **Net Impact** £ Unknown

Key:

Annual costs and benefits:

(Net) Present Value

Evidence Base (for summary sheets)

Introduction

This Impact Assessment should be read in conjunction with the Government's summary of responses: *Regulating the sale and rent back market: summary of responses to consultation* (available at: <http://www.hm-treasury.gov.uk>). It draws on analysis presented in HM Treasury's consultation: *Regulating the sale and rent back market: a consultation* (also available at: <http://www.hm-treasury.gov.uk>), and is informed by the data collected and presented by the Office of Fair Trading (OFT) in its report: *Sale and rent back – An OFT market study* (available at: http://www.offt.gov.uk/shared_offt/reports/consumer_protection/offt1018.pdf). This Impact Assessment also reflects comments and concerns received during the consultation process.

The sale and rent back market offers some homeowners the option of selling properties at discounted rates in exchange for tenancy arrangements. Some stakeholders have expressed concerns regarding this market. At Budget 2008, the Government announced that the Office of Fair Trading (OFT) would lead a study of the sale and rent back market, focusing on consumers' experience of these arrangements, and consider options where appropriate to strengthen consumer protections.

The OFT launched a formal market study on 14 May 2008 and published its findings on 15 October 2008.

The OFT found that the sale and rent back market is not working well for consumers, and recommended that the Government should introduce specific statutory regulation of the market by the Financial Services Authority (FSA). In response to this recommendation, the Government announced that HM Treasury would consult on extending the scope of FSA regulation to cover the sale and rent back market.

This Impact Assessment estimates the potential costs of market failure in the sale and rent back market, which have informed the Government's policy decisions in relation to this market.

The Government's consultation invited views on three policy options, with the objective of ensuring the effective regulation of the sale and rent back market. These options were:

- Option 1 – Maintain existing framework – This option would involve the Government continuing to enforce existing regulatory regimes where applicable, and taking no further action to improve consumer protection;
- Option 2 – Self-regulation – This option would involve the Government encouraging the development by industry of one or more voluntary codes of self-regulation; and
- Option 3 – FSA regulation – This option would require the Government to bring forward legislation to extend the scope of FSA regulation to cover the sale and rent back market.

This Impact Assessment presents the estimated costs and benefit of these policy options, which have informed the Government's decision legislate to extend the scope of FSA regulation to include sale and rent back agreements.

This Impact Assessment also analyses each option against three criteria which the OFT considers relevant to the sale and rent back market functioning well, which are:

- transparency: A lack of transparency can result in consumers being misled in various areas of sale and rent back agreements (for example market value, market rent, period of tenure);
- suitability: Whether some consumers are persuaded to enter a sale and rent back agreement when it is not the most suitable option, considering their circumstances; and
- product quality: Even where a sale and rent back agreement is suitable for the consumer, a lack of product quality means that it entails high risks to the consumer (for example, the risk of eviction due to the landlord defaulting on mortgage payments).

Specific Impacts Tests have been performed for the option the Government has decided to take forward.

Market failure in the sale and rent back market

There are costs to consumers from sale and rent back, in that the price they are offered for their property can be significantly below what they would be offered in a well-functioning market. This is important for sale and rent back consumers, as they are likely to have a lower income than sale and rent back providers, and therefore the net impact on social welfare of this additional foregone equity can exceed the monetary value of this transfer.

There are also risks to consumers entering into sale and rent back agreements, in terms of the lack of lack of certainty around security of tenure. Some of the potential negative outcomes resulting from this identified by the OFT were set out in HM Treasury's consultation.

There are firms which offer sale and rent back in good faith and supply consumers with a service which some find valuable, as it can potentially lower their monthly outgoings and allows them to stay in their own home. However, the current model requires the consumer to bear a large amount of risk, even where they are supplied in good faith.

There is evidence of market failure, caused by an asymmetry of information. The lack of (or provision of misleading) information on the part of the sale and rent back provider may lead to poor outcomes for consumers, such as early eviction, which entails significant financial and psychological costs and therefore decreases consumer welfare.

Sale and rent back agreements and alternatives available are complex to evaluate, particularly for consumers already in stressful situations. Research conducted by the OFT suggests that consumers are not in a position to make a balanced assessment at the point of sale. There is a significant body of research which confirms that consumers have difficulty understanding and assessing risks in relation to financial products generally, even outside stressful circumstances.¹ This difficulty is often compounded by a lack of transparency in relation to the sale and rent back agreement being offered. Behavioural economic theory also suggests that consumers are likely to be myopic when considering a trade-off that involves outcomes with different time horizons – in this case between clearing debts in the short term and the long-term implications of the sale and rent back agreement.

The OFT found that the majority of negotiations relating to sale and rent back agreements were conducted by professional sales people, who in some cases may also play on the emotional or psychological aspects of a sale and rent back agreement (for example, attachment to a family home). Transactions often take place in the consumer's home, where people are typically more vulnerable to persuasion and deals can take place very quickly, as was found in relation to the OFT's study on doorstep selling.²

In addition, many consumers do not feel able to talk openly to others about their problems, placing considerable weight on informal assurances. For example, of the respondents to the OFT omnibus survey who had made enquiries about sale and rent back, over a third did not take advice from anyone, including friends and family.³

The OFT found that sale and rent back consumers are unlikely to shop around, but this may be in part due to time pressures; and some consumers may have little choice in any case. However, even in less pressured circumstances, consumers do not always shop around for financial products.⁴ Where consumers do not shop around, price competition is unlikely to be effective. Consumers may receive less for the purchase of their property, or pay more to rent it back than should be the case in a competitive market. Given the sums involved, these represent a potentially significant source of costs to consumers.

¹ FSA research shows that people often have misconceptions when it comes to financial products. For example, 40 per cent of those who own an equity ISA are not aware that its value fluctuates with stock market performance (Financial Capability in the UK: Delivering Change, *Financial Services Authority*, March 2006).

² Doorstep Selling – A report on the market study, *Office of Fair Trading*, May 2004, Annex F.

³ Sale and rent back – An OFT market study, *Office of Fair Trading*, October 2008, Annex A.

⁴ For example, the FSA found that 33 per cent of those who purchased insurance bought their policy without comparing it to one other product (Financial Capability in the UK: Delivering Change, *Financial Services Authority*, March 2006).

Lack of shopping around also has implications for reputational effects in this market. There do appear to be some reputational effects; for example, some firms receive business through referrals from existing customers. However, many consumers prefer not to discuss their situation with others and may be reluctant to disclose when they experience problems. These factors, in combination with the extent of fragmentation in the market, reduce the scope for reputational effects. The OFT's assessment in this regard was that reputation was not sufficiently important in this market to prevent firms from reneging on aspects of their promises on occasion or from exploiting vulnerable consumers.

Furthermore, for most consumers a sale and rent back agreement will be a one-off transaction. Consumers are unlikely to have had previous experience and may not know anyone else who has. This means that there is almost no scope for learning effects; that is, consumers cannot be expected to learn from their mistakes and avoid making the same mistakes in the future. The absence of this potential feedback channel as an additional disciplinary mechanism further hampers competitive forces in this market.

Therefore, many consumers will not be aware of, or able to assess the full costs and risks they face in sale and rent back transactions. This may result in consumers being persuaded to enter into sale and rent back arrangements when this is not a sustainable solution for them.

Cost of sale and rent back agreements

There is limited information about the sale and rent back market, which is a relatively new market that has grown rapidly in recent years. HM Treasury's consultation summarised the OFT's analysis of the market, which suggests the market is highly fragmented with perhaps more than 1,000 providers, comprising a very large number of small firms and a small number of larger providers. Responses to consultation confirmed this picture of a very large number of small providers, although estimates of the number of providers varied. Some suggested it could be higher, as the number of landlords (of which sale and rent back providers could be considered a subset) was estimated at 1.2 million in the Rugg review.⁵ Others suggested that the number could be lower, arguing that landlords who may have entered into a single sale and rent back agreement should not be considered to be providers in the same way as firms which have a business model focusing exclusively on sale and rent back agreements. The Government does not agree with this distinction, and the Government's approach will be reflected in legislation.

The OFT's market study reported that more than 50,000 sale and rent back agreements may have taken place. Responses to the consultation broadly agreed with analysis which suggests growth in the market is likely to be restricted in the near future due to current restrictions in the availability of credit, through which many sale and rent back providers finance their agreements. Some responses suggested that the market may have contracted by as much as 50 per cent since the OFT published its report in October 2008, although estimates of the scale of this contraction varied.

Notwithstanding the limited information about this market, and the range of estimates of market size, this Impact Assessment presents an estimate of the costs incurred by consumers when they decide to enter into a sale and rent back agreement. This uses results from a survey published in the OFT report, which gives a sample of the distribution of discounts to market value paid to sale and rent back customers. This analysis does not focus on those cases reported to advisory organisations such as Citizen's Advice (which may produce a skewed sample as these are more likely to be cases where consumers experienced poor outcomes), but on a sample of responses to an industry trade association survey.

⁵ Rugg J and Rhodes D, *The private rented sector: its contribution and potential*, *Centre for Housing Policy, University of York*, 2008.

Table A.A: Proportion of market value paid, sale and rent back provider survey

Proportion of market value paid (%)	Number of responses
0 – 49	1
50 – 59	0
60 – 69	2
70 – 79	59
80 – 89	93
90 – 100	11

Source: Sale and rent back – An OFT market study, Office of Fair Trading, October 2008, Chapter 3.

The OFT estimated that most properties involved in this kind of transaction are seldom valued at more than £200,000. The industry reports that a typical client (even in areas of high value property, such as the home counties) was someone who had exercised a “right to buy” their property from their local authority. An analysis of case studies submitted to the OFT by Citizens Advice, Shelter and National Debtline was consistent with this assessment, with the average price paid for the property being around £158,000. For the purposes of estimating costs to consumers, the lower bound was set at an average market value of £100,000; deliberately low, to give an indication of the effect of lower average house prices.

The counterfactual is that all consumers receive what could be considered a ‘fair’ price of 85 per cent of the market value for their property (to represent the conditions of a well-functioning sale and rent back market). This would occur through the elimination of sale and rent back providers that offered low prices (anecdotal evidence suggests some prices are below 50 per cent) and an increased risk burden for all sale and rent back providers which would reduce prices offered, including those currently in excess of 85 per cent. One response to the consultation questioned the use of the term ‘fair’ price, arguing that fairness is too subjective to be used in cost estimates. Other responses suggested that the value of this ‘fair’ price was too high, comparing it with the average price paid in home reversion plans (30 per cent to 35 per cent of market value).

The Government recognises the concerns about subjectivity, but considers that the use of ‘fair’ price in this context provides a useful method of calculating the cost of sale and rent back agreements. The Government notes the concerns about the level of this ‘fair’ price, and the comparisons with equity release products. For the purposes of this calculation, the Government does not consider these appropriate comparisons, as the greater discount in home reversion sales is offset by the right to stay in the property rent-free for life. Sale and rent back sellers do not have this right, and so it is appropriate that the ‘fair’ price in the case of sale and rent back agreements is higher than for home reversion plans.

As set out in the Impact Assessment published with the Government’s consultation, 85 per cent is used as an approximation, derived as an average of the proportion of market value paid in the survey above. The OFT found evidence to suggest that most sale and rent back providers pay between 70 and 90 per cent of the market value of the property.⁶

Overall, these calculations suggest that, if findings from the survey mentioned above are extrapolated to the estimated 50,000 sale and rent back transactions that may have been undertaken to date, the overall costs to consumers so far in terms of equity forgone in sale and rent back transactions as a result of not being able to receive a ‘fair’ price, is -£69.3 million to £837.4 million. This range suggests that some consumers could currently be getting a good price, and that the market may have provided a net benefit to consumers of £69.3 million. However, the distribution of the range indicates that the market may have resulted in a net cost to consumers, potentially as great as £837.4 million.

As FSA regulation will not be retrospective, the above figure represents a cost to the economy that will not be regained. However, such costs can potentially be avoided in future.

⁶ Sale and rent back – An OFT market study, *Office of Fair Trading*, October 2008, Chapter 3.

Even if, as responses to the consultation have suggested, the sale and rent back market has contracted as a result of deteriorating economic circumstances, the number of agreements entered into is likely to remain significant. Estimating the likely costs of 5,000 sale and rent back transactions per year, using the same methodology as above and extrapolating survey findings to consider 5,000 transactions per year, the cost to consumers in terms of foregone equity would be -£6.9 million to £83.7 million per year.⁷

Although this foregone equity represents only a transfer of wealth from sale and rent back consumers to sale and rent back providers, this can have a significant impact on the relative welfare of the two parties to this transaction once distributional considerations are taken into account.

In its report, the OFT identified some common traits of consumers most likely to be involved in sale and rent back transactions, namely that the majority are:

- aged between 50-60;
- unemployed or in low paid jobs;
- in debt, with the perception that their financial situation is out of control; and
- unlikely to take financial advice.

It is therefore likely that the value placed on the foregone equity by the sale and rent back consumer is greater than the value placed on that equity by the sale and rent back provider. In this way, a transfer between economic actors can have a significant net impact, in this case negatively, on social welfare. On the basis of the evidence available, it is not possible precisely to quantify the scale of this net impact on consumers. However, it seems likely that significant costs are being incurred by large numbers of consumers.

These calculations do not take into account a number of other potential sources of costs; for example, costs through stress and its impact on health or family relationships.

In addition, the above calculation focuses only on one element of the sale and rent back transaction: the property sale. Sale and rent back customers appear to experience their most significant costs due to the tenancy agreement element of the transaction; for example, instances whereby the consumer is evicted from rented accommodation after the expiration of a tenancy agreement, when rent is suddenly and significantly increased, or situations in which consumers pay above market rents. Case study analysis conducted by the OFT indicates that 31 per cent of consumers who had proceeded with a sale and rent back agreement had been evicted or were threatened with eviction (even though the majority of these were not reported as having difficulties with affording the rent). Around half of these were facing eviction because their landlord had defaulted on the mortgage.⁸ The cost estimate presented above is therefore likely to underestimate the true extent of costs to consumers associated with sale and rent back transactions. A number of responses to the consultation agreed with this analysis, and recognised the difficulty in quantifying these costs.

Responses to consultation highlighted that early eviction may have social costs, in addition to those faced by the consumer, resulting from any increase in homelessness, notably the high costs of temporary accommodation, and increases in access to health services arising from the stress associated with this form of accommodation. This Impact Assessment does not provide an estimate for these costs.

Option 1 – Maintain existing framework

This option would involve continuing to enforce the existing regulatory regimes where applicable, and taking no further action to improve consumer protection. This option represents a baseline against which the impact of the two alternative policy options will be measured, and it is therefore appropriate to address the existing framework of consumer protection legislation.

⁷ Stakeholders have suggested a range of figures to the Government, before and during the consultation. Some responses suggested that 5,000 transactions was an overestimate, and others that even following market contraction, this figure represented an underestimate. For the purposes of this consultation, the Government considers 5,000 to represent an appropriate balance between these divergent views, and a conservative estimate in light of figures at the higher end of the range suggested.

⁸ Sale and rent back – An OFT market study, *Office of Fair Trading*, October 2008, Annex C.

Consumer protection legislation

There is potentially a range of existing regulations and legislation that have relevance in this market. The OFT's report highlighted that the Consumer Protection Regulations (CPRs), Consumer Credit Act 1974 (CCA) and Estate Agents Act 1979 (EAA) all have some application to the sale and rent back market.

However, the CCA and EAA provide only limited protection, as they apply only to a subset of sale and rent back providers and transactions. The CCA, for example, only applies to those sale and rent back providers that offer debt adjusting or debt counselling; EAA only covers those sale and rent back providers engaged in estate agency. Analysis by the OFT suggests that these two pieces of legislation would only cover a small part of the total sale and rent back market; for example, of 149 sale and rent back providers checked against the OFT's database of credit licences (required for activities under CCA) only 17 matches were found. A summary of existing consumer protection legislation and what they cover regarding the sale and rent back market is appended to this Impact Assessment.

The CPRs, which introduce a general prohibition on businesses treating consumers unfairly, cover the whole industry, and are designed to address some of the conduct which has been identified as a concern in this sector, such as pressure selling and misleading statements on security of tenure. There is potential for enforcement action to send a clear signal about unacceptable practices and to have a deterrent effect on such conduct. This deterrence could also be achieved merely through the existence of the CPRs, although the apparently recurrent nature of problems in the sale and rent back market would suggest that the CPRs are not, by themselves, deterring the kind of behaviour that is leading to costs to consumers.

As one of the relevant enforcement bodies for the CPRs (along with Local Authority Trading Standards Services and the FSA), the OFT believes that the deterrent effect of a successful enforcement action would not be sufficient to prevent potentially extensive costs to consumers in the sale and rent back market. The fragmentation of the industry limits the effectiveness of ex-post enforcement action as a deterrent. Other concerns identified by the OFT, such as the suitability of the product and the level of risk it poses to consumers, are not covered by the CPRs. Furthermore, even where firms have breached the CPRs, the regime as yet offers no direct redress to consumers, who may have suffered significant costs.

The only possibility for redress under these regulations at present would appear to be for individual consumers to pursue action retrospectively through the courts. However, it seems unlikely that sale and rent back consumers would be in a position to undertake such action, given the time and financial resources involved. In addition, this can only occur after any costs have already been incurred, after the consumer has experience problems. Furthermore, it is probably likely that sale and rent back consumers are unaware of such provisions that would allow them to do this.

Responses to the consultation broadly agreed that the risk of costs to consumers associated with sale and rent back do not appear to be addressed by action under the CCA or EAA or under general consumer protection law (through the CPRs).

Costs

The costs of this option are those incurred by sale and rent back consumers. As calculated above, the estimated potential costs to consumers of foregone equity as a result of entering into a sale and rent back agreement are -£6.9 million to £83.7 million per year. The scale of other potential costs to consumers arising from sale and rent back agreements is unknown, but is likely to be significant.

One response to the consultation suggested that the costs of this option would include those arising from further damage to consumer confidence, were the current negative reputation of the sale and rent back market to continue. This Impact Assessment does not estimate these costs.

Benefits

There are no tangible benefits for this option.

Assessment against OFT criteria

- Transparency: Under the current framework it would be difficult to drive up transparency. The CPRs may potentially protect the consumer after the agreement has already been entered into, but the costs to consumers will have already been incurred
- Suitability: Without further action, it is likely that consumers would still undertake sale and rent back deals which might not be the most suitable option for their needs
- Product quality: Without further action, product quality is unlikely to increase, while the risk to the consumer would remain at the same level

Option 2 – Self-regulation

A number of self-regulatory initiatives have emerged. A number of sale and rent back trade associations are gaining membership and developing voluntary codes of conduct for their members. The self-regulation option would involve the Government encouraging the development and adoption by the sale and rent back industry of one or more of these codes.

Reputational effects are an important consideration in evaluating the likely efficacy of a self-regulatory solution. Where consumers are taking a planned decision (as happens when entering into a mortgage), reputational effects can be powerful and self-regulation may achieve a high rate of coverage and impose a strong discipline on the sector. However, where consumers are taking decisions in pressured circumstances (as with many sale and rent back agreements), reputational effects may be weaker.

Given the lack of shopping around and the pressure under which decisions are taken, it is likely that many prospective sale and rent back consumers will not look for a badge of quality such as membership of a reputable industry association.

This means that sale and rent back providers are less likely to join such an association, and those that do may have a weaker incentive to abide by their rules, as both the cost of being expelled and the benefits from being a member are low. In particular, there appears to be little incentive to sign up for those providers that are potentially imposing the highest costs on consumers.

Incentives to abide by trade association rules are further weakened given the difficulty of policing such rules in a fragmented industry, where many transactions are conducted face-to-face.

Therefore, it seems unlikely that self-regulation will have wide coverage and a strong disciplinary effect on the sector. In addition, emerging initiatives do not appear adequately to address the risks to consumers. ‘Lifeboat’ schemes, for example, do not seem to be workable in all circumstances (which may reflect difficulties in selling on properties where sale and rent back tenants are paying rent at below-market rates), and evolving self-regulation schemes do not require member firms to pre-fund redress of compensation arrangements to any significant degree.⁹

As set out in the Government’s summary of responses, the Government welcomes the ongoing work by industry to drive up standards of best practice in this market, but notes that the majority of respondents to the consultation agreed with the OFT that self-regulation is unlikely to provide appropriate consumer protection in the sale and rent back market.

Costs

Unknown. Self-regulation may have some effect on the costs to consumers of foregone equity as a result of entering into a sale and rent back agreement, and therefore this value is unknown. The value of other potential costs to consumers arising from sale and rent back agreements may also be affected by self-regulation. Given the probable extent of coverage and degree of discipline imposed by self-regulation, and the lack of compensation and redress, the costs for consumers are likely to be significant.

Self-regulation may also impose costs on sale and rent back providers, in particular compliance costs. These are likely to be lower than those imposed by statutory regulation, and given the probable extent of

⁹ For example, by posting a bond as a condition of joining a scheme that would then contribute towards any potential future claims made against fellow scheme members.

coverage, not all providers would incur compliance costs. One response to the consultation noted that the costs of self-regulation would vary depending on the model employed, but without greater detail about start-up and monitoring costs it is difficult to estimate the financial burden which self-regulation will represent to providers and any monitoring body. Providers that have not signed up to self-regulatory initiatives may incur costs caused by reputational effects. Given that reputational effects in the sale and rent back market are likely to be weak, the value of these costs is likely to be small. The value of costs for providers (caused by compliance and reputational effects) is therefore likely to be small.

Benefits

Unknown. Self-regulation may have some effect on the costs to consumers of foregone equity as a result of entering into a sale and rent back agreement, and therefore this value is unknown. The value of other potential costs to consumers arising from sale and rent back agreements may also be affected by self-regulation. Given the probable extent of coverage and degree of discipline imposed by self-regulation, and the lack of compensation and redress, the benefits for consumers are likely to be small.

Self-regulation may lead to benefits for sale and rent back providers, by improving the reputation of both specific providers and the market as a whole. Given that reputational effects in the sale and rent back market are likely to be weak, the value of these benefits is likely to be small.

Assessment against OFT criteria

- **Transparency:** This may be increased, by for example, developing minimum standards for documentation but this depends on the form of self-regulation. Some of the emerging self-regulatory initiatives have already developed documentation along these lines.
- **Suitability:** It is not clear if self-regulation will ensure that consumers do not take up the product when it is not suitable for their needs
- **Product quality:** Self-regulation has the potential to raise product quality, but the extent to which this occurs will depend on coverage and discipline in adhering to agreed rules. It is not clear that current self-regulatory initiatives will achieve this.

Option 3 – FSA regulation

In parallel with HM Treasury's consultation, the FSA consulted on its proposals for an interim regulatory regime for the sale and rent back market. The Government will legislate to extend the scope of FSA regulation to include sale and rent back agreement and, subject to Parliamentary approval, the FSA will commence its interim regime in July. The FSA will then draw up and consult on rules for a full regulatory regime and, subject to further consultation, will introduce its full regime in the second quarter of 2010. This Impact Assessment considers the costs and benefits of the full regulatory regime.

In the Impact Assessment published with the Government's consultation, the regulatory regime for home reversion plans (which are regulated by the FSA) was used as a comparison, as there are some structural similarities between sale and rent back agreements and home reversion plans. This revised Impact Assessment, however, uses figures taken from the FSA's consultation paper on its interim regime. The Government considers these to be a more appropriate guide to the likely cost of full regulation, given the differences between the markets for home reversion plans and sale and rent back agreement. The Government also recognises that the costs of interim regulation may be lower than those for full regulation, and so has used the FSA's upper-bound estimates of these costs as an approximation.

Costs

As acknowledged by the OFT in its report, a requirement which shifts some of the risks currently borne by consumers back onto sale and rent back providers could increase the costs of providing the arrangement in some cases, perhaps significantly. These increased costs faced by providers are likely to be passed on, at least in part, to consumers, which could result in a reduction in the number of arrangements.

Sale and rent back providers will incur costs of compliance. In estimating these costs, this Impact Assessment draws on the FSA's assessment of the costs associated with regulation of home reversion, on the basis that these products are the most suitable comparison for sale and rent back agreements.

For the purpose of this Impact Assessment the Government expects regulation of the sale and rent back market to involve the following sources of costs for compliant firms:

- registration/authorisation of firm;
- compliance with high level principles (which apply to all FSA firms) including on fair treatment of customers;
- disclosure/transparency requirements, including risk warnings as appropriate;
- requirements on advice standards (where advice is given);
- advertising requirements;
- standards for firms, including capital requirements and competence standards; and
- access to redress.

The FSA originally estimated that the incremental costs associated with regulating home reversion plans would be significant. Depending on the type of firm, estimates of the one-off costs ranged from £8,000 to £115,000 per firm, while annual ongoing costs ranged from £2,000 to £13,000 per firm. As the size and structure of the sale and rent back market is different to that for home reversion plans, the costs of regulation for sale and rent back agreements are likely to be lower than those described in the FSA report looking at regulation of home reversion plans.¹⁰ This is reflected in the FSA's consultation paper on its interim regime for sale and rent back agreements, which estimates one-off costs of £8,000 per firm and annual ongoing costs of £14,100 to £20,100 per firm. As costs of full regulation are likely to be higher than those for the interim regime, this Impact Assessment uses the maximum figure in this range (£20,100 per firm) as an estimate of the costs of full regulation.

Converting these per-firm costs to an industry-wide aggregate cost requires information about the market. This calculation requires assumptions to be made about the number of firms in the market (1,000), and the likelihood of firm exit. In order to represent the maximum potential cost of regulation this Impact Assessment considers the costs to industry if no firms exit, and all firms take on the extra costs of compliance. This results in potential costs to sale and rent back providers of compliance with regulation, with estimated one-off costs of £8 million and ongoing costs of £20.1 million per year. These costs differ from those presented in the Impact Assessment published with the Government's consultation for the reasons noted above, and the summary pages have been amended to reflect these changes.

An additional cost to sale and rent back providers would be any reduction in the price paid by sale and rent back consumers, due to increased competition in the sale and rent back market, following regulation. That discount could also be used to subsidise sale and rent back consumer rental payments. Regulation could result in some of the transfer reverting to consumers in the form of lower rents.

Regulation may result in all of the transferred equity reverting to consumers in the form of increased security of tenure and lower rental rates. This would then impose an additional ongoing cost to firms of - £6.9 million to £83.7 million.

There will also be direct costs of regulation incurred by the Government to introduce and implement proposals for regulating the sale and rent back market. The FSA has estimated that one-off costs for introducing its interim regime will be £45,000. It is likely that these costs will be incurred again when full regulation is introduced, so the Government anticipates a total one-off cost of £90,000. The FSA has estimated that it will incur ongoing costs of £10,000 per year.

Another potential indirect cost to Government may be through the impact on the burden of work for advice centres that are funded by Government (for example, Citizens Advice). Were regulation to be implemented, there might be a reduction in the number of customers requiring advice when they get into difficulty with sale and rent back agreements. There is, however, likely to be an increase in the need for advice upon entering such an arrangement. Overall it is anticipated that the cost impact on advisory centres is likely to be negligible.

¹⁰ http://www.fsa.gov.uk/pages/Library/Policy/CP/2006/06_08.shtml.

Benefits

The OFT argued in its report that regulation could:

- provide some direct protection for consumers – by, for example, providing access to redress, although this may not be taken up by sale and rent back customers;
- raise standards across the industry – by, for example, vetting suppliers, setting minimum standards; and
- have a positive reputational impact, which would give both consumers and other businesses more confidence in dealing with sector.

There may be positive effects on competition arising from regulation. These are discussed in the Specific Impact Test below.

In addition to the positive impact resulting from increased competition, it is possible that regulation could have a positive impact on the price received by sale and rent back customers in a different way, as those sale and rent back providers which offered the lowest prices (with the highest discount to actual market value) will most likely no longer operate in the sale and rent back market if regulation is implemented. Therefore, the lowest end of prices offered to consumers will be eliminated, which might raise prices offered to sale and rent back consumers.

The OFT identified three groups of consumers who are likely to be affected by the recommendations:

- those consumers for whom sale and rent back is the most suitable way of releasing equity from their home will benefit from a high quality product;
- some consumers for whom sale and rent back is not suitable will be diverted towards more suitable alternatives; and
- some consumers who were previously dissuaded from sale and rent back because of concerns surrounding the products may now proceed with the transaction.

The first two of these groups are addressed as part of the estimate of overall benefits to consumers by reducing foregone equity below, but the last of these groups is not included. Consumers in this last group may have been dissuaded from sale and rent back agreements because they were well-informed and understood the risks posed by these products. If this is the case, the return of this group of consumers represents the entry of well-informed and proactive consumers, who will drive competition effectively. This is then an additional source of potential benefit that could be provided by regulation.

In terms of assessing the value of the positive impact on prices described above, this Impact Assessment uses the inverse of the costs to consumers of result of foregone equity. Assuming that sale and rent back providers are wealthier than sale and rent back consumers, distributional implications are accounted for by attaching weights. Annex 5 of the Green Book¹¹ suggests that the relative marginal utility of an additional pound on net income to the lowest quintile can be up to double that of someone with an average income. On that basis, the benefits for sale and rent back consumers may be multiplied by a factor of one (for a lower bound) and two (for an upper bound), giving a range for annual benefits to consumers of -£6.9 million to £167.4 million.

Although there is little evidence to suggest that wronged sale and rent back customers are pursuing legal action (and those that are probably represent a very small minority in any case), it is possible that regulatory certainty and clarity about sale and rent back agreements may also have an indirect impact by reducing legal costs, through a lower incidence of sale and rent back cases being brought to court as a result of litigation.

Assessment against OFT criteria

- **Transparency:** Disclosure will facilitate transparency in the sale and rent back sector, raising standards of professional conduct, insofar as some providers will be less attracted to operating in a regulated sector.

¹¹ http://www.hm-treasury.gov.uk/data_greenbook_index.htm.

- Suitability: If consumers are able to compare products more easily and accurately assess the risks and uncertainties associated with sale and rent back transaction, there should be fewer people undertaking sale and rent back when it is not in their best interests to do so.
- Product quality: Product quality should increase through regulation.

Specific Impact Tests

Small Firms Impact Test

There will be at least some fixed costs associated with regulation and these fixed costs may impact disproportionately on small firms. It is therefore possible that there will be some restructuring and consolidation of the market in response to regulation. Some sale and rent back providers may exit, and these are most likely to be private landlords and undertaking only a small amount of sale and rent back activity. Others might merge, or perhaps join a franchise group or other network.

There are a great number of small firms operating in the sale and rent back market. Some responses to the consultation suggested that the majority of sale and rent back suppliers have less than ten properties in their portfolio; and research suggests that 5 per cent of landlords hold at least one sale and rent back property in their portfolio. This points to there being as many as 37,500 sale and rent back providers in the UK, although some responses suggested this was an overestimate. There is, therefore a large and disproportionate potential cost to small firms.

Competition Assessment

As noted above in relation to the impact on small firms, regulation may have a significant impact on the structure of the sale and rent back market, which could have conflicting effects on competition.

For example, a number of responses to the Government's consultation suggested that a potentially significant number of (likely smaller) providers might leave the market. This could be due to the associated costs of regulation, or to sanctions under regulation representing such a significant deterrent for some providers that they left the market. This would have the effect of increasing concentration in the market and result in a potentially negative impact on competition. In its report, the OFT also notes that some consolidation and/or development of more extensive franchise or network operations is likely.

There may, however, also be positive effects on competition arising from regulation. As noted by the OFT in its report, regulation may make entry from other potential providers (previously deterred by negative reputational effects of involvement in sale and rent back) more likely. There will also be potential benefits to competition of new consumers entering the sale and rent back market, who were previously dissuaded from doing so due to the degree of risk associated with the sale and rent back agreement.

The OFT's analysis of the sale and rent back sector suggests that price competition is not currently very strong. Improved disclosure and increased information provided to consumers could improve this and allow consumers to shop around more freely and easily.

Given these conflicting forces, it is therefore difficult to estimate the net impact on competition of regulation in the sale and rent back sector. The Government does not, however, anticipate a significant reduction to competition under this scheme.

Gender Equality Impact Test

This has been considered and the Government has not identified any risk of consumers being excluded on the ground of gender from benefiting from any potential changes.

Disability Equality Impact Test

This has been considered and the Government has not identified any risk of consumers being excluded on the ground of disability from benefiting from any potential changes.

Race Equality Impact Test

This has been considered and the Government has not identified any risk of consumers being excluded on the ground of race from benefiting from any potential changes.

Specific Impact Tests: Checklist

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	No	No
Rural Proofing	No	No

Summary of relevant consumer protection legislation

Regulation	When does it apply?	Application to sale and rent back	What does it provide for?
Consumer Credit Act 1974 ('CCA')	Sale and rent back transactions fall outside the scope of the CCA except insofar as the sale and rent back provider may be carrying out an 'ancillary credit business' such as debt-adjusting or debt-counselling.	Will apply to sale and rent back where debt advice on loans (other than first charge mortgage) is given.	Debt-adjusting or debt-counselling requires a licence. To gain a licence, the firm must satisfy fitness requirements. The OFT can revoke the licence. Agreements made without a licence are likely to be unenforceable but there is no direct form of redress under the CCA in relation to losses incurred (except under the general law, for example breach of contract or misrepresentation).
Estate Agents Act 1979 ('EEA')	Applies to those engaged in 'estate agency work', essentially those who receive instructions to introduce buyers and sellers of a property in order to secure its sale.	Will apply to sale and rent back providers that sell property on.	The OFT can prohibit sale and rent back providers from carrying out estate agency work if they are satisfied that the person is unfit. From 1 October 2008, estate agents have been required to belong to a redress scheme.
Consumer Protection from Unfair Trading Regulations 2008 ('CPRs')	Applies to unfair commercial practices by traders, including those which are misleading (by action or omission) or aggressive and which cause the consumer to take a transactional decision he would not otherwise have taken, or which are included in a list of specific commercial practices which are unfair in all circumstances and prohibited.	Will apply to sale and rent back firms that provide false or deceptive information, or engage in pressure selling or in a prohibited practice, such as falsely claiming to be a signatory to a code of conduct.	A range of enforcement action, including criminal and civil proceedings, may be taken against those who breach the CPRs. Consumers may not seek redress themselves under the CPRs but may seek compensation under the general law (for example breach of contract or misrepresentation).
Advertising Regulations	Complaints about misleading advertising can be made to Advertising Standards Authority (ASA) under voluntary codes, before action is taken under CPRs.	Will apply to sale and rent back firms that provide false or deceptive marketing communications.	Provider to amend/withdraw unlawful marketing communications. If they fail to do so, sanctions are applied. Non-complying parties may be subject to enforcement action, for example under the CPRs (see above).
Unfair Terms in Consumer Contracts Regulations ('UTCCRs') 1999	A contractual term is unfair if it has not been individually negotiated and if, contrary to the requirement of good faith, it causes a significant imbalance in the parties'	Will apply to sale and rent back where contract is not individually negotiated. Additionally, the price payable and rent charged or length of the agreement may form the main subject	An unfair term of a supplier is not binding on the consumer.

	rights and obligations under the contract, to the detriment of the consumer. It does not apply to terms which define the main subject matter of the contract which are expressed in plain intelligible language.	matter of contract and therefore not subject to the unfairness test.	
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