

## EXPLANATORY MEMORANDUM TO

### THE CLIENT MONEY PROTECTION SCHEMES FOR PROPERTY AGENTS (APPROVAL AND DESIGNATION OF SCHEMES) REGULATIONS 2018

2018 No. [XXXX]

AND

### THE CLIENT MONEY PROTECTION SCHEMES FOR PROPERTY AGENTS (REQUIREMENT TO BELONG TO A SCHEME ETC.) REGULATIONS 2018

2018 No. [XXXX]

#### 1. Introduction

- 1.1 This explanatory memorandum has been prepared by the Ministry of Housing, Communities and Local Government and is laid before Parliament.
- 1.2 This memorandum contains information for the Joint Committee on Statutory Instruments.

#### 2. Purpose of the instrument

- 2.1 The Client Money Protection Schemes for Property Agents (Approval and Designation of Schemes) Regulations 2018 (“the Approval Regulations”) make provision for the Secretary of State to approve or designate client money protection (CMP) schemes for the purposes of the Client Money Protection Schemes for Property Agents (Requirement to Belong to a Scheme etc.) Regulations 2018 (“the Requirement Regulations”). The latter impose on property agents a requirement to be a member of an approved or designated scheme and make provision for the enforcement of the duty.

#### 3. Matters of special interest to Parliament

##### *Matters of special interest to the Joint Committee on Statutory Instruments*

- 3.1 The instruments have been laid together as they are best understood together and pressures on Parliamentary time are great. However, the intention is to bring the Requirement Regulations into force approximately nine months after the Approval Regulations. This delay is to enable CMP schemes to be approved and/or designated and give property agents time to join those schemes, before agents can be penalised for non-membership.

##### *Other matters of interest to the House of Commons*

- 3.2 These entire instruments apply only in relation to housing in England.
- 3.3 The Requirement Regulations apply to property agents who are persons who engage in English letting agency work<sup>1</sup> or English property management work<sup>2</sup>. The provisions of these Regulations are enforced by local authorities in England (see

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<sup>1</sup> See section 54 of the Housing and Planning Act 2016 for the definition of English letting agency work

<sup>2</sup> See section 55 of the Housing and Planning Act 2016 for the definition of English property management work.

regulation 5(1)) and a breach of the Regulations can only occur in England (see regulation 5(2)).

- 3.4 These instruments do not have minor or consequential effects outside England.
- 3.5 In the view of the Department, for the purposes of House of Commons Standing Order 83P the subject-matter of these entire instruments would be within the devolved legislative competence of the Northern Ireland Assembly if equivalent provision in relation to Northern Ireland were included in an Act of the Northern Ireland Assembly as a transferred matter, the Scottish Parliament if equivalent provision in relation to Scotland were included in an Act of the Scottish Parliament, and the National Assembly for Wales if equivalent provision in relation to Wales were included in an Act of the National Assembly for Wales.
- 3.6 The Department has reached this view because it considers that the primary purpose of these instruments relates to the letting and management of housing in England which is within the devolved legislative competence of each of the three devolved legislatures. The primary purpose of the subject matter of these instruments is not within Schedule 5 to the Scotland Act 1998 and is not otherwise outside the legislative competence of the Scottish Parliament (see section 29 of that Act). The primary purpose of the subject matter of these instruments is not within Schedules 2 or 3 to the Northern Ireland Act 1998 and is not otherwise outside the legislative competence of the Northern Ireland Assembly (see section 6 of that Act). The primary purpose of the subject matter of these instruments is not within Schedule 7A to the Government of Wales Act 2006 and is not otherwise outside the legislative competence of the National Assembly for Wales (see section 108A of that Act).

#### **4. Legislative Context**

- 4.1 Sections 133 to 135 of the Housing and Planning Act 2016 (“the Act”) enable the Secretary of State to require, by regulations, that property agents in England be a member of a CMP scheme that is approved or designated by the Secretary of State and to make provision for the content of those regulations.
- 4.2 Section 133(1) provides that the Secretary of State may by regulations require a property agent to be a member of an approved or designated CMP scheme and that those regulations may impose requirements about the nature of the membership that a property agent must obtain. Section 133(3) requires the Secretary of State to include in regulations under section (1) provision requiring property agents to act transparently by requiring them to obtain a certificate confirming their membership of the scheme, display or publish the certificate, and produce a copy of the certificate on request.
- 4.3 Section 134 permits the Secretary of State to make provision about the approval or designation of CMP schemes, including the process of applications for approval, the conditions which schemes must satisfy before approval or designation, the conditions with which schemes must comply and the withdrawal of approval or revocation of designation.
- 4.4 Section 135 enables the Secretary of State to make provision about the enforcement of requirements to belong to a scheme.
- 4.5 This is the first exercise of the powers in sections 133 to 135 of the Act.

## **5. Extent and Territorial Application**

- 5.1 The instruments extend to England and Wales.
- 5.2 The territorial application of these instruments is set out in Section 3 under “Other matters of interest to the House of Commons”.

## **6. European Convention on Human Rights**

- 6.1 Heather Wheeler, Parliamentary Under Secretary of State (Housing and Homelessness) has made the following statement regarding Human Rights:

“In my view the provisions of the Client Money Protection Schemes for Property Agents (Approval and Designation of Schemes) Regulations 2018 and the Client Money Protection Schemes for Property Agents (Requirement to Belong to a Scheme etc.) Regulations 2018 are compatible with the Convention rights.”

## **7. Policy background**

### *What is being done and why*

- 7.1 The policy objective of these instruments, taken together, is to ensure that all letting and managing agents in the private rented sector are members of an effective CMP scheme.
- 7.2 CMP schemes give landlords and tenants confidence that their money is safe when it is being handled by an agent. Where an agent is a member of a CMP scheme, it enables a tenant or landlord to recover any money held by the agent on that person’s behalf that the agent fails to repay – for example because of misappropriation or insolvency.
- 7.3 The industry estimates that letting agents currently hold approximately £2.7 billion in client funds. These monies are frequently rent payments to landlords but can also include monies held by agents for repairs and maintenance to the property. Membership of a CMP scheme is not currently mandatory but it is estimated that around 60% of agents are already members of such a scheme.<sup>3</sup>
- 7.4 Following passage of the Act, the Government invited Baroness Hayter and Lord Palmer of Childs Hill to chair a working group to review how CMP schemes work in the lettings sector and whether to make membership of such schemes mandatory.
- 7.5 The review found that awareness of CMP schemes amongst landlords and tenants is low, despite the transparency requirements introduced in the Consumer Rights Act 2015, which require agents to publicise whether or not they are a member of a CMP scheme. Tenants and landlords tend to trust their letting and managing agents and assume that they are regulated by the law. Tenants also often have no choice over which letting agent they use since this is chosen by the landlord. Tenants shop around for properties, not agents, and thus transparency measures have not to date had their intended impact of increasing the number of agents with CMP scheme protection.
- 7.6 Following the report of the working group, the Government announced its intention to accept the group’s recommendation that membership of a Government approved or designated scheme should be made mandatory.

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[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/603365/Client\\_Money\\_Protection\\_Working\\_Group\\_Report.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/603365/Client_Money_Protection_Working_Group_Report.pdf)

- 7.7 Mandatory membership of a CMP scheme will give landlords and tenants confidence that every agent offers consistent protection. It will be unlawful for property agents to handle client money if they do not belong to a CMP scheme. Agents unable to pass the due diligence requirements to access CMP cover will not be able to handle client money, thus protecting consumers. However, agents that are unable to obtain CMP cover would still be able to trade without handling client money, for example by allowing the tenant to pay the rent directly to the landlord. CMP requirements will rebalance the lettings sector in favour of the responsible agents already in CMP schemes, as competitors outside those schemes will now also have to procure CMP membership to protect their clients' money.
- 7.8 The Approval Regulations set out the process that must be followed in relation to the approval of CMP schemes, including that schemes must apply in writing to the Secretary of State for approval. They also set out the conditions which must be satisfied before the Secretary of State may approve a scheme.
- 7.9 In terms of the administration of a scheme, the conditions include a requirement for the scheme to appoint an independent scheme administrator and secure insurance cover commensurate to the size and number of members and amount of money held by such members. The conditions also require schemes to specify the process for making claims for compensation and the process for handling such claims and any complaints. These requirements regarding scheme administration will ensure that landlords and tenants are well protected regardless of which scheme their agent chooses to be a member of.
- 7.10 Schemes will only be approved if they meet the conditions regarding their 'scheme rules', including rules relating to the handling of claims by the scheme. For example, the rules must provide that the scheme will reimburse landlords/tenants in full and as soon as reasonably practicable in the event of a member failing to return client money to which that client is entitled. Schemes must also accept claims for at least twelve months after the date of a case occurring. This will ensure landlords' and tenants' money remains protected in the event that their agent ceases to belong to the CMP scheme or goes out of business.
- 7.11 In terms of members joining schemes, the scheme rules must set out membership criteria (i.e. how to join or leave the scheme). They must also require scheme administrators to deal with scheme closure notices so that scheme members are notified as soon as reasonably practicable, new members are not taken on (or renewals accepted) and the members can be transferred, at no cost, to an alternative provider before the scheme closure date. This is so that in the event of a scheme being served with a closure notice, members are not suddenly left without cover or asked to pay towards moving, to ensure continuation of cover.
- 7.12 The scheme rules must also require members to meet certain conditions in relation to the handling of client money. This includes a requirement to hold money in a separate client account and to have written transparent procedures for handling client money (including repayment) and to maintain adequate records of all dealings with client money. Members are also required to hold an appropriate level of professional indemnity insurance (PI) cover. This is to ensure that CMP schemes are not overwhelmed with claims related to employee fraud, so that in the first instance, a client claim for reimbursement is dealt with by the agent's insurers. If property agents were not insured this could cause a substantial increase in the cost of premiums for the scheme itself which would likely be passed on to members as part of the cost

of scheme membership. Moreover, if only some schemes required agents to have PI, there is a risk that some landlords and tenants would find that the level of cover by their agent's CMP cover would be lacking when needed. The requirement mitigates this risk.

- 7.13 The Approval Regulations allow for the Government to designate a Government-administered CMP scheme. The requirements for designation and revocation of designation of a scheme are aligned to the requirements for approval and withdrawal of approval of a scheme. The Government does not intend to create such a scheme at this time as it believes there is sufficient market provision. However, this provision protects agents—and their tenants and landlords—by enabling the Government to maintain CMP provision in the unlikely event that it is otherwise at risk.
- 7.14 To enable members to comply with their obligation to display their membership certificate (set out in the Requirement Regulations), the Approval Regulations also include conditions relating to transparency. Schemes must provide their members with a certificate confirming their membership of the scheme. Also, schemes must provide such information relating to a member's membership or a claim under the scheme as may be required by other approved CMP schemes, property redress schemes, tenancy deposit protection schemes and relevant enforcement bodies and regulators (such as Trading Standards) in connection with their functions.
- 7.15 Finally, in order to allow the Secretary of State to monitor the effectiveness of schemes and hold them to account, the Approval Regulations also include conditions relating to reporting and withdrawal of approval. They will be required to share information with the Secretary of State on the operation of the scheme on a quarterly basis. To account for where standards are not being maintained the Approval Regulations make provision for the Secretary of State to withdraw a scheme's approval.
- 7.16 The Requirement Regulations require letting agents to belong to an approved or designated CMP scheme. They are intended to be brought into force approximately nine months after the Approval Regulations: this will give time for the approval of schemes and for agents to sign up to a scheme before the membership requirements come into force.
- 7.17 Agents will be required to adhere to the transparency requirements. This includes obtaining and displaying a certificate confirming scheme membership, and informing clients when they lose or change CMP cover.
- 7.18 Local authorities will be responsible for enforcing these requirements. There will be a civil penalty of up to £30,000 for non-compliance with the requirement to belong to a scheme and a penalty of up to £5,000 for non-compliance with a transparency requirement: this will act as a strong deterrent. Local authorities will be able to retain the monies collected from civil penalties to fund enforcement. The Schedule to the Regulations set out the process that must be followed to impose a civil penalty for a breach of the Regulations and makes provision for a right of appeal to the First-tier Tribunal.

#### ***Consolidation***

- 7.19 No consolidation is necessary.

## **8. Consultation outcome**

- 8.1 The Government published a consultation on 1 November 2017 regarding the implementation of mandatory CMP scheme membership.<sup>4</sup> The consultation closed on 13 December 2017 and received 106 responses from a range of stakeholders, including existing CMP providers, letting agents, tenants, landlords, and local authorities.
- 8.2 63% of respondents were in favour of a market-led approach, where scheme providers are approved by Government in order to operate. 77% of respondents supported Government mandating conditions for a CMP scheme to be approved or designated.
- 8.3 74% of agents felt that responsibility for enforcing the duty should be at County Council level, whilst others felt it should be either at District Council level or that there should be flexibility across areas.
- 8.4 The Government published its response to the consultation on mandatory CMP scheme membership on 1 April 2018<sup>5</sup>. The response confirmed the Government will require that CMP schemes meet certain conditions and obtain approval from the Secretary of State.
- 8.5 The response set out that the Government will support a market-led approach as there is currently sufficient provision in the market. The legislation allows for the government to designate a government-administered CMP scheme to maintain CMP provision in the unlikely event that the market ceases to provide it.
- 8.6 The response also confirmed the approach to enforcement of CMP requirements. The Housing and Planning Act 2016 enables the Secretary of State to provide for enforcement by local authorities in England as defined at section 135(5) and means enforcement at district council level in a non-unitary authority, or at county council level in areas where there is no district authority. The Government will use the Tenant Fees Bill to amend the definition of local authority in England at s135(5) of the 2016 Act so that enforcement responsibility will be at County Council level, ensuring consistency of enforcement with other letting agent regulation. In the interim, ahead of the Tenant Fees Bill coming into force district councils in non-unitary authorities will be able to discharge their enforcement responsibility to other tiers.

## **9. Guidance**

- 9.1 The Department will provide scheme providers with guidance on the process for approval. This will be published on gov.uk when the Approval Regulations come into force.

## **10. Impact**

- 10.1 The impact on business, charities or voluntary bodies of the Approval Regulations is that CMP scheme providers will be required to apply for approval and must comply with the conditions set out by the Secretary of State in order to operate as an approved scheme for the purposes of the Requirement Regulations. The impact on business, charities or voluntary bodies of the Requirement Regulations is that where they are carrying out letting agency or property management work in the private rented sector and handling client money in the course of a business they will have to join one of the

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<sup>4</sup> <https://www.gov.uk/government/consultations/mandatory-client-money-protection-schemes-for-property-agents>

<sup>5</sup> <https://www.gov.uk/government/consultations/mandatory-client-money-protection-schemes-for-property-agents>

approved client money protection schemes (or a designated government administered scheme, if applicable).

- 10.2 There is no impact of the Approval Regulations on the public sector. The impact of the Requirement Regulations on the public sector is that local authorities will need to enforce the duty.
- 10.3 An Impact Assessment is submitted with this memorandum and is published alongside the Explanatory Memorandum on the legislation.gov.uk website. A hard copy of the Impact Assessment may also be obtained from the Ministry of Housing, Communities and Local Government, Fry Building, 2 Marsham Street, London SW1P 4DF

## **11. Regulating small business**

- 11.1 The legislation applies to activities that are undertaken by small businesses.
- 11.2 No specific action has been taken to minimise the regulatory burden on small businesses.
- 11.3 The basis for the final decision on what action to take to assist small business was to ensure that all consumers are protected regardless of which agent they or their landlord choose. Larger agents tend to be members of professional organisations which require CMP scheme membership as part of the membership package. SMEs are less likely to, therefore, have CMP cover than the larger agents. It is therefore important to include SMEs in the mandatory requirement to ensure consumers' money is protected, regardless of the size of the firm in order to secure that the objective of the legislation is met.

## **12. Monitoring & review**

- 12.1 Heather Wheeler, Parliamentary Under Secretary of State (Housing and Homelessness) has made the following statement regarding the duty to review regulatory provisions in secondary legislation: it is not appropriate to make provision for review of the Requirement and Approval Regulations. A review of the requirements relating to CMP scheme membership and provision would be disproportionate in relation to its low impact. The Department believes it is more appropriate to monitor the impact of these instruments alongside wider property agent regulation measures, such as the ban on tenant fees and regulation of letting agents. The Government will monitor the number of agents joining approved schemes and the operation and effectiveness of approved schemes on an ongoing basis and the Approval Regulations will require scheme administrators to report to the Secretary of State on a quarterly basis.

## **13. Contact**

- 13.1 Laurence Morton at the Ministry of Housing, Communities and Local Government Telephone: 0303 444 6765 or email: Laurence.Morton@communities.gsi.gov.uk can answer any queries regarding the instrument.