

# Client Money Protection

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A working group review to consider whether  
Client Money Protection should be made  
mandatory for letting and management agents

**March 2017**



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## Introduction from the Joint Chairs

This Report, which we present to the Minister, Gavin Barwell MP, sounds rather dry: “Client Money Protection”. But it’s about something that is key to every family – their home – and for landlords, it is about something equally important – their investment and often their main asset. This is what this report is about: safeguarding private sector rents when tenants pay these via a letting agent. The problem has been that this money, whilst in the custody of the agent, although belonging to the tenant or the landlord, is unprotected. So if the agent makes off with it, or if the agent goes insolvent, the money disappears. If it was stolen by the agent, it’s literally gone. If the agent is insolvent, other creditors seize the money. Either way, the landlord or tenant loses.

Letting agents are already required to belong to a redress scheme, but this may not help a client if, when awarded redress, the agent has gone insolvent and there’s no one to pay the compensation.

We share the Government’s desire to increase the range and quality of homes in the private rented sector. However, this requires confidence by landlords that there is no risk of money going astray, either because deposits have not been protected (despite the law) or rents have disappeared. Given how this sector increasingly houses older people, and families with children, their security is too important to be left to chance. Our Report strongly recommends that all letting and managing agents who handle client money must protect it via a Client Money Protection (CMP) Scheme.

Most agents already have this in place. However, some (mostly small) letting agents do not. We heard some quite heart-rending stories from both tenants and landlords of the losses they incurred. With tenants, they then don’t have the deposit for their next home. For landlords, they have lost a large part of the income on which they rely. Too often the actions of the agent (whether through negligence or lack of experience going bust, or straight criminality) only come to light after the money has gone. CMP offers protection when problems occur.

We know that the Government shares our view on the desirability of agents having CMP. Indeed, in the Consumer Rights Act 2015 they added a requirement for agents to publicise whether they have this, as a way of increasing take-up. The problem with relying only on transparency is – as the Group has found – that landlords are unaware of CMP or its importance, and tenants can’t shop around as it’s not them who select an agent. Hence our recommendation to use the reserve power put into the Housing and Planning Act 2016 by the Government to mandate CMP.

The costs of CMP to a letting agent are not great. However, the cost of not having it, to a landlord or tenant, is too great, and too important for the minority of agents

without CMP to be allowed to continue to hold client money. Making CMP compulsory need not deter start-ups, as they can either use a custodial scheme, or act only as an introducer rather than handling client money until they have a track record. Mandatory CMP would deter the rogue, and indeed the amateur who should not handle other people's rent without security.

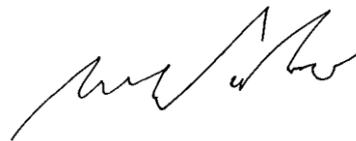
In making this recommendation to the Government, we commend them for including the reserve power in the Bill, for establishing this Group which has been so expertly facilitated by Department for Communities and Local Government officials led by Jane Everton, and for the Minister's willingness to meet us and the tenants and landlords who came to give oral testimony to the Group.

We are particularly grateful to our three Working Group Members (Ian Fletcher, Martin Harland, David Sparkes) who agreed to put their experience and expertise at our disposal to work through the issues, and challenges, of considering mandatory CMP, and to all those who gave evidence, in both writing and in person.

The Group looks forward to the Government's response, and stands willing to help with the implementation of any decision which flows from our work.



Baroness Hayter of Kentish Town



Lord Palmer of Childs Hill

## Executive Summary

1. Client Money Protection (CMP) is a scheme that ensures landlords and tenants are reimbursed in the event of a letting or managing agent going into administration, or where the agent misappropriated their money whilst in his/her custody or control. Membership of a CMP scheme in England is currently not compulsory.
2. A working group was formed in Autumn 2016 with a remit to decide on whether it would be appropriate to recommend mandating that CMP be taken out by letting agents in England as a prerequisite for being able to trade as such.
3. The Housing & Planning Act 2016 provides a delegated authority to the Secretary of State to decide on whether to require that letting agents in England be a member of:
  - A CMP scheme that is approved by the Secretary of State; or
  - A CMP scheme that is Government-administered; and
  - The Secretary of State may also impose requirements as to the nature of the CMP scheme.
4. The working group considered both written and oral evidence from a wide range of stakeholders. The majority of evidence suggested that stakeholders (including the sector) are in favour of mandating CMP. 85% of the survey responses during the call to evidence were in favour, arguing that mandatory CMP would improve the reputation and professional standards in the industry as well as giving consumers the financial protection that they want and deserve. It would also bring the sector into line with others where client money is held, for example the legal profession and travel operators.
5. It is presumed that it is those agents that do not have CMP voluntarily that are more likely to abscond with or abuse client money in their custody. Mandatory membership of a CMP scheme would help to drive up standards across the sector (especially if eligibility for the scheme comes with additional obligations).
6. Compulsory CMP would ensure that each and every agent was offering the same level of protection to boost consumer confidence. Those agents who are unable to pass the due diligence requirement to access CMP cover should not, by definition, be able to continue to handle client money, in order to protect consumers.
7. Although this report inevitably considers the impact of the transparency requirements, which were introduced as part of the Consumer Rights Act 2015,

on the letting agents sector, it should not be interpreted as a comprehensive review of those requirements.

8. However, both in the written and oral evidence, it was clear that respondents did not consider that the changes on transparency had achieved their hoped-for effect of increasing the coverage of CMP, or in raising awareness of its existence/absence to inform landlords' and tenants' decision-making. It is not anticipated that this position would improve, even with further time for the transparency requirements to bed in. Indeed, the very small increase in the number of agents with CMP, despite the transparency requirements, is one of the reasons for the widespread support for making CMP mandatory.
9. It should be noted that any discussion on how to tackle rogue landlords is beyond the scope of this report, the focus is on the practice of letting and management agents. Also out of scope of this report is consideration of mandatory Client Money Protection in the Devolved Administrations.
10. The recommendation of the working group is to move forward with the mandating of CMP for agents in England that handle client money. The working group is keen to minimise the impact on the sector and does not want to restrict new firms entering the sector. As such, the group does not recommend that membership of a professional body should be a requirement to obtain CMP cover. The group also recommends a transitional implementation to give agents time to become compliant.
11. The implementation of mandatory CMP will need good communication and should be in parallel with other changes to this sector to ensure a smooth transition. In particular, successful implementation will depend on robust and effective enforcement of the requirement, to ensure compliance and deter agents who handle client money from not obtaining cover.

## Recommendations

12. The working group recommends:

1. The Government uses its powers in the Housing and Planning Act 2016 to make Client Money Protection mandatory and gives further consideration as to how to manage implementation and enforcement.
2. Minimum terms and conditions of cover and agreed standards are dictated either by Government or a lead enforcer to ensure that schemes are consistent in their approach, underwriting and claims pay-outs.
3. Enforcement is by local authorities, primarily Trading Standards but with flexibility to allow enforcement by local authority private sector housing teams that have regular contact with landlords, letting agents and tenants.
4. Providers of CMP, redress schemes and Trading Standards share information to ensure that compliance can be checked.
5. The Government considers authorising a prime authority for enforcement, recognising CMP schemes and providing up to date information. This authority should hold information that can be shared with other relevant organisations on which agents are compliant with the requirement to trade with CMP.
6. If an agent is found to be handling client money without having CMP, they should be fined or shut down. Agents who receive fines for non-compliance should not be permitted to continue to handle client money.
7. The Government, or its appointed authority, should issue guidance and ensure sufficient communications to support implementation.
8. British Bankers Association in liaison with the Government to produce guidance for banks on enabling the opening of client bank accounts without the need for evidence of due diligence on individual landlords.
9. Measures on CMP are linked to the work underway on the ban on letting agent fees for tenants. Any other changes to the sector should be considered in the round and implemented in a sensible and coherent way.
10. Implementation of mandatory CMP should be done on a transitional basis.

## Introduction

13. During the passage of the Housing and Planning Act 2016 it became clear that there was a broad range of support for taking action to mandate CMP. The Government therefore introduced an enabling power in the Act for the Secretary of State to make regulations by affirmative procedure to require letting and property management agents to have CMP cover, which involves client money being held in a separate, protected bank account. The primary legislation also provides a clear enforcement mechanism of a financial penalty for agents who fail to comply with the requirement.
14. DCLG established a small working group in Autumn 2016 whose remit was to look at the available evidence and decide on whether it would be appropriate to recommend mandating that client money protection be taken out by letting and management agents as a prerequisite for being able to trade as such.
15. The working group was chaired by Baroness Hayter of Kentish Town and Lord Palmer of Childs Hill, reflecting their knowledge and commitment to CMP. A small group of experts from local government, the private rented sector and a technical expert were appointed to work with Department for Communities and Local Government (DCLG) officials, Baroness Hayter and Lord Palmer:
  - Martin Harland, Head of London Borough of Camden Trading Standards and Chair of the London Trading Standards Lettings Group
  - Ian Fletcher, Director of Policy at the British Property Federation
  - David Sparkes, Head of Compliance and Training, British Insurance Brokers' Association
16. The working group was kept deliberately small in order not to fetter the views of those wishing to present evidence or create conflicts of interest for those who may be affected by making CMP mandatory.
17. The working group was supported by a call for evidence, inviting all interested parties to submit their views. The call for evidence was published on gov.uk and via surveymonkey.com in August 2016. It was sent directly to targeted recipients including local authorities, Trading Standards, the police, professional bodies for the property industry (National Approved Letting Scheme (NALS) and Association of Residential Letting Agents (ARLA)), landlord bodies (National Landlord Association (NLA) and Residential Landlord Association (RLA)), consumer and tenant organisations (Crisis and Shelter), landlord and tenant solicitors' firms, the three tenancy deposit protection scheme organisations, the Government backed redress schemes, the Royal Institution of Chartered Surveyors (RICS) and the UK Association of Letting Agents (UKALA).

18. The call for evidence ran for six weeks after which time the working group held six oral evidence sessions to explore evidence provided by stakeholders. 54 individuals and organisations responded to the call for evidence. The questions asked during the call to evidence can be found at Annex A, a summary of the written responses to the call to evidence is at Annex B, those stakeholders that participated in the oral evidence sessions is at Annex C and a summary of the six oral evidence sessions is at Annex D.

## **The Private Rented Sector**

19. The private rented sector is an important part of our housing market. It has almost doubled in size in the decade from 2004-5 to 2014-15, housing 4.3 million households in England. The sector now represents 19% of all households, up from 11% in 2004-05. The sector is likely to continue to grow with an increasing number of families and tenants seeking longer term tenancies. As the private rented sector grows, it is vital to ensure that the interests of the consumer are protected.

20. Letting and managing agents are engaged by private landlords to manage rental accommodation on their behalf. Their duties might include finding tenants, collecting rent, and responding to queries from tenants once they are in place (for example, in relation to repairs).

21. The working group heard evidence of the important service that agents provide in ensuring that properties are safe, compliant and professionally managed. However, there can be serious consequences for both landlords and tenants when agents do not comply with their responsibilities and do not deliver a high standard of service (whether through negligence, lack of experience or criminality).

22. It is important to maintain confidence in the growing private rented sector. Landlords need to be assured that their interests are protected if they are to continue to invest in providing good quality buy-to-let properties. The Government has already taken action in this area; letting and managing agents are required to be members of a Government approved redress scheme. Agents are also required to publicise a full tariff of their fees, whether or not they are a member of a CMP scheme and of which redress scheme they are a member, prominently in their offices and on their website.

23. Client Money Protection is an essential part of building confidence in the private rented sector and supporting good landlords. The industry estimates that letting agents currently hold approximately £2.7 billion in client funds. These monies are frequently landlords' rental payments but can also include monies held for repairs

and maintenance to the property. Tenants' deposits are protected under separate arrangements.

24. Landlords, or agents acting on their behalf, are required by law to protect tenants' deposits in a Government-approved tenancy deposit scheme. Tenancy deposit protection schemes ensure that tenants will get their deposit back if they meet the terms of their tenancy agreement. If an agent goes into administration the deposits are returned to the tenant not the landlord. Three Government-backed schemes currently hold approximately £3.6bn as deposits, of which 40% is held by third party custodians and 60% by letting agents themselves but backed by insurance. Insurance backed deposit protection schemes are only available to letting agents with CMP.
25. Should a deposit not be paid into a deposit scheme by a letting agent (despite the requirement by the law), then the money is not protected and the landlord is liable for the loss, though the tenant cannot be guaranteed to get it back.
26. The majority of tenant money is in tenancy deposit protection schemes, which is protected and therefore not the concern of this report. The risk is where tenants pay rent via the agent. The lack of a mandatory requirement for agents to protect client funds is an anomaly in the drive to improve consumer rights in the private rented sector putting both landlords and tenants at risk.
27. There continue to be examples of letting agents misappropriating client funds or using them fraudulently and then disappearing, leaving both landlords and tenants unable to recover their funds. A number of case studies are at Annex E.

### **What is Client Money Protection?**

28. There are two main reasons why a landlord or tenant could lose their money that is held by a letting agent. The first is that the agent is fraudulent; the second is that the agent has gone bankrupt. Client Money Protection ensures that landlords and tenants are reimbursed in such circumstances. If a letting agent is not covered by CMP, both the landlord and tenant could lose their money and there is no route for recompense. CMP schemes give landlords and tenants confidence that their money is safe when it is being handled by an agent.
29. The Government encourages firms to join CMP schemes and encourages landlords and tenants to choose agents with CMP. Participation is voluntary but it is estimated that around 60% of agents already have CMP. Professional bodies require agents to provide CMP as part of their eligibility criteria.

30. Current CMP schemes are completely independent from the letting and managing agents and they do not act on behalf of, or have a duty of care to, the participating firm. In order to be eligible for CMP cover, agents must maintain and operate segregated client accounts where client money is held completely separate from the operating funds of the firm. This ensures that client money does not register as an asset of the agent (but is protected under trust) and cannot be called upon by the business (or other creditors) to meet other costs. (Note: the costs of distribution incurred by an insolvency practitioner will be met from the pool of client money before distribution of the remainder, in accordance with established case law under what has become known as a Berkeley Applegate Order.)

## Enforcement

31. This section of the report covers enforcement looking at both enforcement of existing requirements on agents and also considering mechanisms for enforcing mandatory CMP. Robust and effective enforcement is essential to the successful implementation of mandatory CMP. Enforcement should be a tool to deter agents who handle client money from failing to obtain CMP cover.
32. Clause 135 of the Housing and Planning Act 2016 provides an enforcement mechanism of a financial penalty for agents who fail to comply with the requirement to have CMP.

### Enforcement of Existing Requirements on Agents

#### Redress Schemes

33. Legislation was introduced in October 2014 to require letting and managing agents to be members of one of the three Government approved redress scheme - Ombudsman Services Property, the Property Redress Scheme and the Property Ombudsman. This requirement provides an independent complaint mechanism to help drive up standards in the sector.
34. Each redress scheme publishes a list of members on their respective websites making it possible to check whether a letting or management agency has joined one of the schemes.
35. Ombudsman Services Property, the Property Redress Scheme and the Citizens Advice Bureau thought there were between 20-25% of agents not signed up to a redress scheme. The Property Ombudsman put the number at 5-10%.
36. The redress schemes can issue up to £25k awards to landlords or tenants, and, if these are not paid, agents will be excluded from the schemes (and thus lose the right to trade, as membership of a redress scheme is compulsory). 99% of agents do pay the redress awarded. (The working group heard evidence that complainants would have to take court action to enforce payment of the award granted.)
37. Local authorities can impose a civil penalty of a fine of up to £5,000 where a letting or management agent has not joined a redress scheme. The authority must give written notice of their intention to impose a penalty setting out the reasons and the amount of the penalty. The agent will have 28 days to make

written representations or objections to the authority, starting from the day after the date that the notice was sent.

38. At the end of the 28 day period the enforcement authority must decide, having taken into account any representations received, whether to impose the fine, and if so, must issue a final notice to the agent giving at least 28 days for payment to be made. An agent can appeal against the civil penalty to the First-tier Tribunal.
39. The local authority can impose further penalties if an agent fails to join a redress scheme despite already having had a penalty imposed. There is no limit to the number of penalties that may be imposed.

### Tenancy Deposit Protection Schemes

40. Under the Housing Act 2004, landlords are required to protect any deposits, taken in connection with an assured shorthold tenancy, with a Government-approved scheme. The Act places a duty on the Secretary of State to ensure that one or more tenancy deposit protection schemes are available to allow landlords to meet their obligations under the Act.
41. There are three Government backed tenancy deposit protection schemes – the Deposit Protection Service, MyDeposits and the Tenancy Deposit Scheme – that all offer custodial and insurance-based schemes.
42. Under the custodial scheme, the deposit protection scheme holds the deposit in a bank account for the duration of the tenancy. When the tenancy ends, the scheme passes the deposit to the person who is entitled to it. Under the insurance-based schemes, the landlord or agent retains the deposit but pays a fee to the scheme, which insures against the landlord or agent unlawfully retaining the deposit at the end of the tenancy. If the landlord or agent does not pay the tenant the amount they are owed at the end of the tenancy, the scheme will pay the tenant through its insurance and try to get the deposit back from the landlord or agent.
43. Government contract stipulates that the tenancy deposit schemes have to make their registers searchable so that tenants are able to check whether or not their deposit is protected. The deposit scheme registers are self-funded.
44. If a landlord has not protected a tenant's deposit, the tenant can apply to their local county court. If the court finds that the deposit has not been protected it can order the person holding the deposit to either repay it to the tenant or pay it into a custodial deposit scheme within 14 days. The court may also order the landlord

to pay the tenant up to three times the deposit within 14 days of making the order.

45. At present when an agent leaves or is expelled from a deposit protection scheme, the provider notifies the redress and other deposit protection schemes as well as Trading Standards.

### Client Money Protection

46. Transparency requirements were introduced in the Consumer Rights Act 2015. They require agents to publicise a full tariff of their fees, whether or not they are a member of a client money protection scheme and of which redress scheme they are a member, in their offices and on their website. A fine of up to £5,000 can be levied by local authorities against agents who fail to comply.
47. Transparency measures are intended to drive up standards by enabling landlords and tenants to shop around and choose letting agents with CMP. The requirements still need time to bed in but, to date, resourcing constraints have limited the ability of local authorities to provide full-scale enforcement.
48. One paradox of the current transparency law is that Trading Standards can fine agents who do have CMP but fail to display it, but can take no action against an agent that does not have CMP despite both tenants and landlords being less well protected.
49. SafeAgent and the National Approved Letting Scheme (NALS) commented that they were disappointed by the lack of enforcement to ensure that agents display whether they have CMP. They would encourage local authorities to use the NALS Letting Agent Enforcement Toolkit published in June 2016.
50. Tenants also, in reality, have no choice over which letting agent they use since this is chosen by the landlord. Research shows that tenants shop around for properties, not agents, and thus transparency measures have not had their intended impact to date on driving up the number of agents with CMP.
51. Enforcement of existing requirements on agents is therefore managed primarily by local authorities and in particular by Trading Standards. Trading Standards have issued fines/penalty charge notices (penalty charge notices are civil not criminal penalties) to agents, although local authorities have had trouble collecting them.
52. A number of agents operate online only. Such agents are harder to police. The Chartered Trading Standards Institute pointed out that the transparency

requirements in the Consumer Rights Act 2015 do not specifically require letting agents to display information on property portals (such as Rightmove and Zoopla) and suggested that this should be rectified. The potential for portal operators being able to help in the policing of agents should be explored.

53. Landlords often go to the police first if an agent folds whereas tenants will tend to go to an organisation such as Shelter. Generally, neither thinks to go to Trading Standards. Owing to limited resources, most Trading Standards focus on multiple offenders.

54. Shelter said that because Trading Standards couldn't investigate all cases, it monitors local letting agencies and passes on any information on which Trading Standards could then act. Shelter also has a reporting function on its website and passes on this intelligence to Trading Standards. There are over 4,000 such referrals a year to Trading Standards.

### **Enforcement of Mandatory CMP**

55. The majority of stakeholders believed that enforcement of mandatory CMP should be by local authorities, primarily Trading Standards, but with flexibility to allow enforcement by local authority private sector housing teams that have regular contact with landlords, letting agents and tenants. The evidence sessions raised the issue of how to oversee online only letting agents. This will need to be considered further.

56. The Chartered Trading Standards Institute and the Property Redress Scheme suggested that, since all letting agents are required to belong to an approved redress scheme, these schemes are well placed to check whether agents have CMP as a potential additional enforcement mechanism.

57. UKALA would prefer to see enforcement through the mandated membership of an approved membership body. Another suggestion was to set up a supervisory body to check which agents have CMP and report those that do not to Trading Standards.

58. Trading Standards representatives were supportive of enforcement through a combination of advice and enforcement. There would need to be awareness raising of the necessity for CMP membership with a deadline for all agents to sign up. Non-compliant agents would then receive visits from Trading Standards or private sector housing officers.

59. However, there are resourcing issues for local Trading Standards. The Chartered Trading Standards Institute expressed concerns about Trading Standards

services receiving responsibility for enforcing a new provision since the number of Trading Standards staff has halved since 2010 with no corresponding reduction in responsibilities. As a result, most Trading Standards focus on multiple offenders, with investigations tending to be reactive to complaints.

60. Shelter believed that the number of calls around CMP would rise significantly if CMP were made mandatory since awareness would increase and people are likely to report things they know are unlawful. It would therefore be essential to raise the profile of Trading Standards as the enforcer and ensure that they have necessary resources to monitor and enforce CMP.
61. RICS shares information with Trading Standards and other law enforcement agencies/regulators but there needs to be better data sharing across CMP providers, redress schemes and Trading Standards. To assist enforcement, ARLA said that they would support data sharing arrangements whereby they would confirm to relevant enforcing bodies whether an agency has CMP through their scheme. This data is already available on the ARLA website.
62. It would also be important to establish a mechanism for redress schemes, Trading Standards and CMP providers to inform landlords of agents who have been removed from a CMP scheme. Any sharing of information by CMP providers, enforcers, redress schemes and others would need to comply with data protection legislation.

#### Penalties for non-compliance

63. There was broad consensus that if an agent was found not to have CMP, or a scheme refuses to accept them, they should be fined or shut down (albeit that the working group is conscious that the legislation provides no power to shut down a company). Where an agent is fined, the agent should not be permitted to handle client money for a fixed period (again the working group is conscious that the legislation provides no power for this currently).
64. Any fine would be a civil penalty and would be enforced through penalty charge notices in the same manner as the civil penalties for failing to belong to a redress scheme are enforced. Many stakeholders suggested that fines should be at least £5,000, in line with the penalty for not joining a redress scheme, but the Residential Landlords Authority said that fines should be proportionate to the size of the organisation.
65. Enforcement funds raised from the penalty notices should be retained by the relevant council department, as under the redress schemes, and ring-fenced for

further enforcement activities. Alternatively, part of the CMP membership fee could be used to fund enforcement.

66. Most stakeholders agreed that there would need to be a clear and effective mechanism to recover the penalty notice levy and a further penalty for any fine not paid. It was suggested that agent directors could be held personally accountable. For example, the official receiver, appointed by the courts, who deals with insolvencies can currently apply for a disqualification order to disqualify a director and is also able to apply for a bankruptcy restriction order.

67. London Trading Standards representatives thought that those letting agents who could be shown to be trading without CMP should be banned under the Housing and Planning Act 2016 and also be placed on the rogue agent database that is being established.

68. However, there are no powers in the Housing and Planning Act 2016 to make failure to obtain CMP a criminal offence and it therefore could not be a banning order offence under current legislation. The powers in the Act do allow for further civil penalties to be imposed if an agent fails to obtain CMP despite already having had a penalty imposed.

#### National Register

69. Enforcement of CMP should be supported by the creation of a single national register where landlords and tenants can check the redress scheme of which their agent is a member and whether their money is protected by CMP. It was suggested that landlords should be able to sign up for a service that notifies them when an agent's CMP cover lapses. Consideration of how such a register could be established was outwith the remit of the working group.

70. Many stakeholders wanted to go further than a CMP register and suggested that letting and management agents should be licensed in order to practice. Such a requirement could be used for wider enforcement of the sector and could help to drive up standards and eliminate rogues.

#### Lead enforcement body

71. There was widespread support for a lead enforcement body, possibly along the lines of the National Trading Standards Estate Agency Team (NTSEAT), hosted by Powys County Council, which is designated by the Secretary of State as the UK's lead enforcement authority for the purposes of the Estate Agent Act 1979.

72. NTSEAT is responsible for issuing formal prohibition or warning orders to unfit individuals or businesses under the Act and for the approval of redress schemes in the property sales sector. NTSEAT is also designated as a Competent Authority for the purposes of the Alternative Dispute Regulations and is responsible for issuing advice and guidance regarding the operations of the Estate Agent Act. NTSEAT has the power to debar if they find an individual or firm is not fit and proper.
73. NTSEAT engages productively with a number of enforcement partners as part of its regulatory role and also works with the estate agency professional bodies, the redress schemes and the Consumer's Association (Which?). Powys Council believes that a similar joined up approach in respect of letting agents, supported by a consumer education programme could eliminate most non-compliance problems.
74. Powys Council believed that having a lead authority for letting agents to develop advice, standards and guidance would be helpful and welcomed by the sector. Given the large number of estate agents that also operate as letting agents, a lead enforcement body in the letting sector would need to work closely with NTSEAT.
75. The working group is supportive of the prime authority approach but further work is needed regarding the costs and whether Powys, or an alternative council, is best placed for the role. NTSEAT is funded solely by the Department for Business, Energy and Industrial Strategy as the Estate Agents Act falls under that Department. Government finances/resources or the ability to charge CMP providers are likely to be necessary to make the arrangement work for letting and management agents' CMP.
76. The working group believed that a prime authority could play an integral role in the enforcement of mandatory CMP. The authority would have responsibility for recognising CMP schemes, possibly setting the minimum standards for such schemes, maintaining the register drawing on CMP providers' list of agents covered and providing up to date information on compliant agents to Trading Standards, redress schemes and other relevant organisations.

## Client Money Protection in the current market

77. This section looks at the provision of CMP in the market today.

### Awareness of and compliance with Client Money Protection

78. The Government encourages letting and management agents to join CMP schemes and landlords and tenants to choose agents with CMP via the [Safe Agent Kite Mark](#)<sup>1</sup>. Participation is currently voluntary. It is estimated that around 60% of agents already benefit from CMP. Agents pay a membership fee (typically around £300-£600 a year) to join a scheme, often as part of wider professional association membership. Failure of agents to join a CMP scheme is likely to be due to lack of awareness or cost concerns rather than criminal intent.

79. Awareness of CMP is low. Tenants and landlords tend to trust their letting and management agents and assume that they are regulated by the law. Indeed, the working group heard no examples of any tenant giving any thought to whether an agent had Client Money Protection (or even knowing what this meant). Tenants are familiar with deposit protection and the working group heard evidence that tenants often thought that the deposit protection schemes provided all of the necessary cover.

80. The National Landlord Association (NLA) noted that many of their members do not understand the requirements on agents or what they should do if their agent goes into liquidation. The British Property Federation (BPF) explained that many smaller landlords in a competitive market will select the agent offering the lowest price, rather than a member of a professional body or an agent offering CMP.

81. There is also a lack of knowledge about existing requirements amongst letting and managing agents themselves. Many agents operate online only. A number do not have their own websites but maintain an internet presence through property portals.

82. Of 18-20 agents visited in October 2016 by a Trading Standards representative most only had one office and only four were members of a CMP scheme. Many agents are small firms and require an explanation as to what CMP is. Many think professional indemnity is sufficient and that CMP is not required.

83. There is a perceived lack of professionalism in the sector and a number of stakeholders argued that letting agents should have to be members of a professional association to be eligible for CMP cover to help drive up standards.

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<sup>1</sup> <http://safeagents.co.uk/>

84. The Citizens' Advice Bureau said that they get around 113,000 complaints a year about the private rented sector, 6,000 of these specifically on agents (although it is often hard to separate landlord and agent so the number could be higher). 30% of calls to the NLA advice line are about letting agents.

### **CMP Providers**

85. The Association of Residential Letting Agents (ARLA), the National Approved Letting Scheme (NALS), the Royal Institution of Chartered Surveyors (RICS) and the UK Association of Letting Agents (UKALA) offer client money protection schemes as part of their membership package with CMP cover being a prerequisite of membership. These schemes are not open to all letting agents but only to members, who have to abide by codes of practice, meet certain entry requirements and be subject to due diligence checks on the operation of their client accounts as well as annual financial reporting.

86. Agents pay their professional association an annual CMP levy, which covers the association's costs of administering the CMP scheme. The association insures itself against its own liability to pay out to a landlord/tenant for members misappropriating client funds. In the event of claims, money is reimbursed, subject to the scheme rules, out of the association's own funds to those who have lost money. The association then reclaims this money via its insurance.

87. CMPProtect and other insurers also offer CMP schemes, which do not require membership of a professional association but do require agents to have professional indemnity insurance and to demonstrate membership of a redress scheme.

88. The scope of each CMP scheme varies but CMP cover generally costs between £300 and £500 a year depending on the size of the firm and the amount of money held in client accounts. For example, ARLA charge £330 per annum for CMP, NALS charge £233 per annum and CMPProtect charge £299 per annum.

89. In order to be eligible for cover, CMPProtect require agents to provide evidence on an annual basis of:

- Professional indemnity insurance cover up to £100,000 (for bigger companies, they can require a higher level)
- Segregated client accounts
- 3 months' bank statements
- Membership of redress scheme

90. CMPProtect also carry out a credit check using data held by Experian. For start-up letting agents CMPProtect accept a credit score of 7, recognising that it can take time to build up a credit score.
91. In addition, agents often have to complete annual compliance checks, usually involving an accountant's report, which can cost up to £1,000.
92. ARLA require all member firms to provide signed off accounts every year. It offers cover of £25,000 per individual, £500,000 per legal entity, up to £3 million a year. NALS checks member accounts every 6 months. It provides cover of £25,000 per individual and there is a maximum of three months' rent cover. The total that can be paid out in any one year is £5 million. RICS provides cover of £50k per individual up to £5 million per annum.
93. Lonsdale's CMP scheme, launched in 2013, is exclusive to members of the Property Ombudsman who have to abide by the Property Ombudsman's code of conduct but do not have to be a member of a professional association. Cover is in two parts: firstly professional indemnity insurance (this is required to be a member of the Property Ombudsman) and secondly Client Money Protection.
94. The information provided by respondents demonstrated that there are no firm figures for the average claim amounts under CMP schemes; claims ranging from £1,500 to £50,000 were cited in the call to evidence. One response calculated the average losses for landlords at £3,000-£4,000 and for tenants at £1500 - £2,000.
95. Landlord groups suggested that agents typically hold rent for 5-7 days before passing on to the landlord. However, the working group heard evidence of rent monies being held for longer. Some tenants, for example foreign students, are asked to pay a year's worth of rent in advance, although this is not the norm.

## Implementation Considerations of Mandatory Client Money Protection

97. This section looks at other key aspects of implementation, aside from enforcement, in order to ensure that mandatory Client Money Protection is effective.

### Minimum Standards and Provider Choice

#### Provider Choice

98. Should Client Money Protection be made mandatory, it will be important to ensure that there are enough providers – CMPProtect and NALS suggested that the field was limited at present. However, Trading Standards bodies noted that if there were too many providers it would make CMP harder to enforce as Trading Standards would need to be checking against a large pool of bodies and be aware of new providers opening and closing.

99. Both Trading Standards and the redress schemes agreed that providers should be licensed by Government and there should be a limited number. However, landlord groups did not think that there should be a cap on the number of providers so long as Government-specified standards were met. The landlord groups did not expect a flood onto the market as only a limited number of companies understand the market. However, they recognised that this number could grow over time similarly to how landlord insurance did when it first became available.

100. The risk of creating a ‘free for all’ CMP market is that, while it may create competition and so ‘regulate’ the cost to letting agents, it may see some insurers speculating on their ability to manage such schemes, then withdrawing from the market when financial results were poor. The deposit protection schemes evidence a stability where schemes are monitored and governed by contract.

#### Minimum Standards

101. Minimum terms and conditions of cover would need to be agreed to ensure that schemes are consistent in their coverage and sufficiently underwritten. Without such, CMP would be harder to enforce and pose difficulties for agents in understanding the limitations of each scheme. The Government should work with the letting and management agent sector and CMP providers to agree a minimum level of cover that provides a suitable level of indemnity.

102. It would be important that such standards are neither too high (to ensure that the majority of agents can get cover and not to deter new entrants) nor too low (which could lead to a race to the bottom). CMP Providers would need to demonstrate that they are meeting minimum standards and providing sufficient cover. Landlords need to have the confidence that their agent has not chosen a scheme due to a cheap fee only to find the protection is not there when needed or is lower than another scheme albeit at a higher fee.
103. CMP schemes should cover misappropriation or theft of client monies as well as insolvency and require segregated client accounts. CMP providers might also require evidence of membership of redress and tenancy deposit protection schemes and of robust audit processes.
104. The British Property Federation suggested that if CMP protected 12 months rent there was a risk that more agents would ask for it. Limiting cover to 3-6 months' rent could mitigate that risk.
105. It would not be possible to require agents to have a minimum number of years of experience in order to be eligible for CMP cover, since it would restrict start-ups. However, CMP providers would need to satisfy themselves that new firms had sufficient knowledge to operate effectively. This could be demonstrated through relevant work experience or formal qualifications, or agents could use a custodial scheme for rents initially.
106. Agents would need segregated bank accounts for client monies to be eligible for CMP cover, so that funds do not register as an asset of the firm and cannot be called upon to meet business expenses, or in the event of insolvency to meet the claims of general creditors.
107. The British Banker Association should produce guidance, in liaison with the Government, that banks are not required to undertake anti-money laundering checks on every landlord whose rents are held in such segregated accounts, as banks gave evidence to the working group that at present they have to undertake due diligence on the final beneficiary in order to operate a client money account.
108. The quality of insurer would be important as there are Managing General Agents setting up in the UK using underwriting capacity from abroad, which may be less stable than from UK-domiciled (and so UK regulated) blue-chip insurers. The Government may need to ensure that underwriting capacity is laid down in the minimum standards as well as minimum aggregate sums insured with limited policy excesses to ensure that consumers get their money back when they are entitled to it.

## Costs

109. Mandatory CMP would require agents to pay to belong to a scheme but stakeholders suggested that for agents who operate professionally and legally CMP is neither difficult to obtain nor expensive. The cost to agents who do not already have CMP should not therefore be an argument for not introducing mandatory CMP. Those agents who are unable to pass the due diligence requirement to access CMP cover should not be able to continue holding client money, so as to protect consumers.
110. It would be important not to restrict new entrants to the market. Joining a CMP scheme would be part of a new firm's set up costs. In order to minimise costs and risk, new entrants might be required to use a custodial scheme for the first year of operation. Further, CMP should only be mandatory for those agents handling client money. A letting agent could still operate but not receive client monies, for example the tenant would pay rent directly to the landlord.
111. The vast majority of respondents to the call to evidence believed that mandating CMP would not impact rent levels. The CMP scheme is a cost to the agent; there is no reason to pass this onto tenants as they are not the beneficiaries.
112. Reimbursement CMP schemes currently in place are relatively cost effective and as such costs are generally absorbed by agents. If CMP schemes have non-fixed fees that vary with an agent's risk profile, this will result in higher premiums for some agents. In this scenario, CMP could become expensive for high risk agents and see some good agents paying the price of subsidising bad practice.

## Professionalisation of the sector

113. Many stakeholders cited the lack of regulation of letting and managing agents in England as problematic and recommended minimum criteria or qualifications for letting agents to be permitted to operate. This would help provide the insurance market with sufficient confidence to provide the cover that CMP schemes need.
114. Making CMP mandatory should help reduce the number of rogue agents and improve the image of the sector. However, a number of stakeholders wanted to go further and believed that CMP schemes should only be operated as part of a professional membership scheme. This would mean that standalone CMP insurance or cover as part of a professional indemnity/fidelity insurance policy would not be permitted.

115. It is already hard to get CMP without joining a professional association or a redress scheme. The majority of providers only offer CMP as part of wider association membership and CMP cover that is managed by insurance brokers tends to require membership of a professional body. However, there is no statutory requirement for agents to belong to a professional body.
116. Powys Council thought that membership of a professional body did not need to be a statutory requirement but could be encouraged through the introduction of an endorsed ratings scheme for letting agents with a link in to an industry code and redress schemes. A voluntary approach would leave a small number who did not want to sign up but efforts could be focussed on these, for example via audits and inspections.
117. The working group recognised the argument that requiring membership of professional bodies would increase professionalism, reduce the number of rogue agents and support mandatory CMP. However, such a requirement would place an additional cost on agents, particularly small firms, and could force any which failed to meet membership criteria out of business. It could also discourage new firms from entering the market. Requiring membership of a trade body in order to be eligible for CMP cover is therefore not recommended at present.
118. However, letting agents not in a professional body might be seen as higher risk by insurers and therefore may be charged higher prices for CMP cover.

## **Communications**

119. The working group identified communications as a priority to ensure successful implementation of mandatory CMP. There is currently a lack of knowledge and understanding about CMP and existing legal requirements amongst agents, landlords and tenants. If CMP were made mandatory, tenant and landlord awareness should increase and it would remove confusion for those who think the same protection as applied to deposits also applies to rent.
120. In order for mandatory CMP to be effective, it is essential that the Government or its authorised body issues guidance and ensures sufficient communications regarding the move to mandatory CMP and the consequences of non-compliance. The Government should update its 'How to Rent' guidance, which has to be issued to all new tenants, to stress that all letting and management agents must have CMP.
121. It would also be important for all insolvency practitioners to be able to determine which bank accounts are client accounts where money is held in trust for the landlord or tenant, so is not part of the business assets, and cannot be

distributed to creditors. If CMP is made mandatory, the Insolvency Service stated that it would amend its guidance to say that all CMP account money should be returned to the client (after deduction of the cost of distributing).

### **Balance of risk for consumer and agent**

122. There is cross-sector support for making CMP mandatory since it would mitigate the risk of landlords and tenants losing money in the event of a letting or managing agent going into administration and against theft or misappropriation. However, making CMP mandatory does not in itself guarantee an appropriate standard of protection. As agents seek to comply whilst still remaining cost competitive they may choose low cost schemes, if available, that do not provide an adequate level of cover for consumers. There is also the issue of rogue agents, who would continue to operate 'under the radar'. Sufficient resources to adequately enforce mandatory CMP will be essential to mitigate this.
123. If CMP is made mandatory, some agents would be unable to obtain cover because of their risk profile (or in the case of start-ups; the lack of a profile) and would therefore be unable to trade as agents that handle client money. This would protect consumers from risky agents but may mean the possible withdrawal from the market of small to medium sized agents.
124. Permitting new providers of CMP to enter the market would increase capacity to help cater for the additional demand that mandating the cover will create. The increased competition should also work to manage the cost to letting agents of this cover.
125. It should be recognised that different types of CMP providers would pose differing degrees of risk to landlords and tenants. The so-called 'composite insurers' (providing insurance cover in many areas to different types of customers) will have sufficient reserves to withstand a requirement to pay multiple claims at the same time. Specialist ('niche') insurers, however, may lack the capital to meet an unexpectedly high volume of claims. That said, niche providers may become the only option for the perceived higher risk letting agents who fall outside the risk appetite of the composite/'mainstream' insurance market.
126. By making CMP compulsory, there will be a period of adjustment for letting and managing agents. A transitional period should help, for example a year's notice to enable agents to become compliant would help minimise the number of agents who are forced to close or stop handling client money, and also not discourage new firms from setting up.

## **Timeframe**

127. It is vital that measures on CMP are linked to the work underway on the ban on letting agent fees for tenants and HM Treasury's Consultation on the 4<sup>th</sup> Anti-Money Laundering Directive, which has been considering whether to bring letting agents within the scope of anti-money laundering supervision.
128. There is increasing pressure to regulate letting agents further. The working group heard calls for mandatory membership of a professional association and a requirement for agents to be licensed in order to practise. It is essential that changes to the sector are considered in the round and implemented in a sensible and coherent way.

## Summary

129. The majority of stakeholders (including the sector) are in favour of mandating CMP, arguing that it would improve the reputation and professional standards in the industry as well as giving consumers the financial protection that they want and deserve. The written and oral evidence presented to the working group supports this view; 85% of respondents were in favour of mandatory CMP.
130. Mandatory CMP would help to raise standards across the sector and operate as a tool to tackle rogue agents. It would ensure that each and every agent was offering the same minimum level of protection to boost consumer confidence. Those agents that are unable to pass the due diligence requirement to access CMP cover should not, by definition, be able to continue to handle client money in order to protect consumers.
131. The working group recommends that CMP should be mandatory for agents that handle client money but urges the Government, in implementing this recommendation, to give due regard to enforcement, timing and communication. The working group is keen to minimise the impact to the sector and does not want to deter start-ups. As such, the group does not recommend that membership of a professional body should be a requirement to obtain CMP cover. The group also recommends a transitional implementation to give agents time to become compliant.
132. Successful implementation of mandatory CMP will depend on robust and effective enforcement of the requirement to ensure compliance and deter agents from not obtaining cover.

## Glossary of Key Terms and Abbreviations

**ARLA** – Association of Residential Letting Agents, a professional body for letting agents

**BPF** – British Property Federation, a trade association for UK residential and commercial real estate

**CMP** – Client Money Protection. Client Money Protection schemes protect the money of landlords and tenants in the event of a letting or property agent going into administration and against theft or misappropriation by the agent whilst it is in their custody or control.

**CMProtect** – a provider of a client money protection scheme

**Custodial** – often used in reference to tenancy deposit protection schemes. Under the custodial scheme, the deposit protection scheme holds the deposit in a bank account for the duration of the tenancy. When the tenancy ends, the scheme passes the deposit to the person who is entitled to it.

**NALS** – National Approved Letting Scheme, a professional body for letting agents

**NLA** – National Landlord Association, a trade association for landlords

**PRS** – private rented sector

**Redress Schemes** – letting agent redress schemes provide a free, independent service for resolving disputes between letting agents, tenants and landlords. There are three Government backed letting agent redress schemes. These are Ombudsman Services: Property, the Property Redress Scheme and the Property Ombudsman

**RICS** – Royal Institution of Chartered Surveyors, a provider of a client money protection scheme

**RLA** – Residential Landlord Association, a trade association for landlords

**SafeAgent** - a promoter of client money protection schemes

**TDP** – tenancy deposit protection. Landlords must place their tenants' deposits in a tenancy deposit protection scheme. The schemes in England are Deposit Protection Service (DPS), MyDeposits and the Tenancy Deposit Scheme (TDS).

**TS** – Trading Standards

**UKALA** – UK Association of Letting Agents, a professional body for letting agents

## Annex A - Call to Evidence Questions

1. How many letting agents offer CMP schemes and what proportion of the market is this?
2. How many CMP schemes exist?
3. What services are typically offered by a CMP scheme?
4. How much does membership of CMP schemes cost?
5. What benefits do you receive as a member of a CMP scheme?
6. Have agents offering CMP seen an increase in business attributable to offering CMP?
7. Does an agent offering CMP affect your decision on whether to use that agent either as a landlord or a tenant?
8. Since transparency measures were introduced in April 2015, what increase or decrease has there been in the percentage of agents voluntarily offering CMP?
9. How many claims have been made on CMP schemes? And what proportion are successful?
10. What is the main reason given for a claim?
11. How many claims are a result of fraudulent activity?
12. What is the average level of a claim?
13. In addition to insurance based schemes, are there any other CMP models? (please describe them, including pros and cons)
14. Should Government make CMP mandatory? (please give reasons)
15. What would be the impact on rents in the PRS?
16. Would tenants be prepared to pay an additional fee if agents offered CMP?
17. How should membership be enforced?

## **Annex B - Summary of written responses provided during the call to evidence**

1. There were 54 respondents to the call to evidence from across the letting sector including: local authorities; Trading Standards; professional bodies for the property industry; landlord bodies; consumer and tenant organisations; landlord and tenant solicitors firms; and tenancy deposit and redress schemes.
2. This paper summarises the responses to the call to evidence covering the questions (at Annex A) on whether CMP should be made mandatory, awareness, enforcement and costs.

### **Should CMP be made mandatory?**

3. Approximately 85% of responses to the call to evidence were in favour of mandating Client Money Protection. Comments in favour of mandating included:
  - It is best practice and should be compulsory – reputable agents who present little risk will choose to join the voluntary CMP schemes whereas rogue and incompetent agents will not join unless membership is mandatory. Tenants and landlords deserve to have their money protected.
  - Agents handle a very significant amount of money on behalf of their clients, and the tenants thereof, and at present there is no legal requirement for them to make any provisions to ensure the security of these funds should the business fail. CMP schemes reduce risk by ensuring that the money will be handled honestly and appropriately.
  - Using a letting agent with CMP might be a factor in the choice made by landlords, but tenants have no choice. The introduction of mandatory CMP would ensure that consumers are able to approach and engage the whole of the market where each and every agent offers the same level of protection and consumer confidence.
  - It would drive up professional standards and compliance in the private rented sector thus improving the image of the sector.
  - There is no qualification or entrance requirement for setting up a letting or management agent. Mandatory CMP would offer some protection, reduce fraud and minimise the impact of agents that adopt poor practices.
  - Without the introduction of mandatory CMP, and with the growing number of online agents and high street agents entering the market who are

unregulated, we could see more instances of misappropriated funds and unacceptable behaviour from a minority of bad letting agents; only fuelling uncertainty for landlords and tenants and further damaging the reputation of the industry.

- No organisation should be allowed to trade with a client's funds. It would not be allowed in the legal profession. Similarly, travel operators are required by law to have CMP. Making CMP mandatory would bring the letting sector in line with others where client money is held.
  - Mandatory CMP would make it easier for regulatory and enforcement services to find those agents who are either trading fraudulently or are incompetent/reckless as they are unlikely to have CMP membership.
  - Given that tenancy deposits are already protected by one of the three Government-backed schemes it would be logical to ensure that rent and other client monies held by letting and property management businesses are also protected. It would also remove confusion from those consumers who think the same protection as applied to deposits also applies to rent and other client monies.
  - Mandatory CMP would address the existing gap in redress for both landlords and tenants if they suffered financial loss.
  - CMP helps ensure that landlords do not evict tenants for rent arrears where rent has been paid but misappropriated by an agent.
  - It would help protect those tenants who may be vulnerable and therefore more likely to be targeted by fraudulent behaviour.
  - There is no compelling reason why it should not be mandatory.
4. However, just over 10% of respondents were opposed to introducing mandatory CMP (the remaining 5% of respondents were indifferent). The principal reason for opposing mandatory CMP was that it may create further burden and cost on agents since CMP is harder to obtain without joining a trade association. Other comments against mandating CMP included:
- There is no reason to suggest that making CMP mandatory would provide a universal cure-all, since similar mandatory provisions in other service areas have not eradicated the issues that CMP would look to address. This is mainly owing to inconsistent enforcement and sentencing across the country.

- It will not make a difference – bad agents and landlords will still misappropriate client money unless appropriate enforcement is put in place.
- Agents with CMP can and do use it as a unique selling point to drive up business.
- CMP would not be needed if central Government instead educated tenants, landlords and agents so that they were more informed about the concept of CMP to the level that the lack of its provision would affect potential transactional decisions since the market would ensure comprehensive coverage.

**Does CMP affect tenants’ or landlords’ decision making when choosing an agent?**

5. Nearly all respondents said that there is little awareness or understanding of the benefits of CMP amongst landlords and tenants. Comments included:

- Clients confuse it with deposit protection schemes and assume that the money that they pay to the letting agent in rent is protected.
- Mandatory CMP would make it easier to get out a consistent message to both landlords and tenants that they should not use letting agencies and property management businesses who are not members of a CMP scheme.
- When choosing an agent, CMP is rarely, if ever, considered by a tenant.
- There is a common misconception that landlords are financially protected against poor practice or business failure on behalf of their agent.

**Has there been an increase in the percentage of agents voluntarily offering CMP since transparency measures were introduced in 2015?**

6. The transparency requirements have been welcomed but many respondents thought that they do not go far enough and that they are not sufficient to be a sole lever to improve the letting market.

7. Many respondents said that they have seen no evidence that the transparency regulations have had any significant impact on driving up the numbers of agents with CMP in the market.
8. Some respondents said that they are disappointed by the lack of effective and consistent enforcement activity to ensure that agents display whether they belong to a CMP scheme.

### **How should membership of CMP schemes be enforced?**

9. The majority of stakeholders believed that enforcement should be carried out by Trading Standards, but with flexibility to allow enforcement by local authority private sector housing teams that have regular contact with landlords, letting agents and tenants. However, there was recognition that Trading Standards would need adequate resourcing to carry out any enforcement responsibilities. Many respondents suggested that Trading Standards should be allowed to keep any fines levied.
10. Other comments made on the subject of enforcement included:
  - The critical aspect of introducing mandatory CMP will be clearly delegating whom responsibility for compliance falls to and resourcing them to achieve it. The key to new regulations will be to either resource local authorities or set up new bodies to enforce and achieve compliance.
  - Enforcement should be simple and robust using a system of penalty charge notices similar to those under the redress schemes. There also needs to be an effective mechanism to recover the penalty notice levy.
  - Membership of CMP schemes should be enforced through a combination of advice and enforcement with non-compliance attracting a level 5 financial penalty.
  - Greater awareness, self-policing by agents and whistle-blowing will help to enforce mandatory CMP.
  - The creation of a one stop easily searchable national database would enable enforcement officers to easily check agent membership of a CMP scheme.
  - Organisations providing CMP membership should provide information and intelligence to Trading Standards to facilitate enforcement as necessary.

- Those letting agents who can be shown to be trading without CMP once CMP becomes mandatory should be banned under the Housing and Planning Act 2016 and also be placed on the rogue landlords' database that is being established.
- It is disappointing that often police forces view theft of clients' money as a civil matter and simply the result of the commercial failure of a business.
- CMP schemes would need to be licensed/appointed by the Government to ensure that a minimum set of limits is available to the consumer and that the insurers sitting behind the scheme are financially robust.
- CMP should be enforced by means of mandatory membership of an approved membership body. This model would build on the existing infrastructure and standards provided by associations and shift the burden of promotion from the Government to these existing professional bodies.

## Costs

11. The vast majority of respondents said that the modest costs of obtaining CMP cover should have no or very minimal impact on rents. However, a minority thought that rents could increase, particularly if rogue agents may take advantage and increase fees. Other comments included:

- For an agent who operates professionally and legally, inclusion under a CMP scheme is neither difficult nor expensive to obtain. If a firm is unable to access such a scheme, then it is clear that they should not be operating in the sector and the consumer needs to be protected against that firm.
- 60% of letting firms are already signed up to CMP schemes and the cost burden on the remaining 40% is not an argument for not introducing mandatory inclusion in a CMP scheme.
- The costs to business associated with mandating CMP will be drastically lower than the implementation costs of other recent legislative changes such as the Right to Rent Checks created under the Immigration Act 2014.
- In the event that rents were increased, the protections offered by mandatory CMP would still be beneficial to landlords and tenants and, at the very least, any charges would be transparent, allowing tenants to choose whether they are willing to pay and, if so, plan accordingly.

## Annex C - Stakeholders who attended the six oral evidence sessions

Banks:	British Bankers Association Royal Bank of Scotland
Enforcement:	Dorset Police National Trading Standards - Estate Agency Team (Powys)
Housing Associations:	National Housing Federation
Insolvency:	The Insolvency Service
Insurance Companies:	Hamilton Fraser Lonsdale Insurance Kerr London Royal Sun Alliance
Landlord Groups:	British Property Federation National Landlord Association Residential Landlord Association
Legal and Property Managers:	Cluttons LLP Winckworth Sherwood LLP
Provider/Promoters of CMP:	Association of Residential Letting Agents Client Money Protect National Approved Letting Scheme SafeAgent UK Association of Letting Agents
Recovery Specialists:	R3 – Association of Business Recovery Member
Redress Schemes:	Ombudsman Services: Property Property Redress Scheme The Property Ombudsman
Sector Representatives:	Association of Residential Managing Agents (ARMA) Royal Institution of Chartered Surveyors
Tenancy Deposit Schemes:	Deposit Protection Service My Deposits Tenancy Deposit Scheme

Tenant representatives: Citizens' Advice Bureau (Hackney Branch)  
Citizens' Advice Bureau (Policy)  
Crisis  
Shelter  
Individual tenants

Trading Standards: Bristol City Council  
London Borough of Havering  
London Borough of Islington  
London Borough of Newham  
Wolverhampton

## Annex D – Summary of CMP Oral Evidence Sessions

### Session 1 – The Providers and Tenancy Deposit Protection Schemes

All organisations had previously stated they were in favour of making CMP mandatory so the discussions focused on how to achieve this, how easy it is to get CMP cover and what checks and balances are in place. The key points made were:

- Across the sector requirements varied and could include members having professional indemnity insurance, segregated client accounts, bank statements, credit checks, redress scheme membership and/or representative body, signed off accounts. Regularity of compliance checks also varied with a minimum expectation to review accounts. The tenancy deposit protection (TDP) schemes identified there would be a large number of agents that could not get cover and would fall away if CMP was mandatory.
- If a large company went into administration, insurance companies would not be able to cope with the pay outs. This is ‘concentration risk’.
- Participants in the session believed that CMP cover should be obtained as part of membership to a professional body. There was little support for stand-alone CMP products since membership of a professional body, and having to satisfy their wider checks, provides extra assurance and drives up standards across the sector.
- Some participants cited difficulties in obtaining ‘client accounts’ from banks and suggested that such accounts could be subject to high fees.
- Public awareness of CMP is generally poor. Making CMP mandatory with effective enforcement would improve awareness.
- If there were a licensing process similar to the TDP schemes, the Government would need to ensure that there were enough providers.
- When an agent leaves or is expelled from a TDP scheme the other schemes and Trading Standards are notified. There was support for a supervisory/notification body that could check which agents have CMP and report those that don’t or pass intelligence to Trading Standards.
- A redress scheme can make an award if an agent is a member of a CMP but does not display it, however if an agent openly displays that they do not have CMP there is no redress available.

## **Session 2 – LA Trading Standards and the Ombudsman Redress Schemes**

All organisations had previously stated they were in favour of making CMP mandatory so the discussions focused on how this would be enforced. The main points were:

- It is the role of Trading Standards to enforce CMP since it would sit with their other work in this area. However, representatives were concerned about the lack of resources. Redress scheme representatives argued that a lack of resources in Trading Standards was not an adequate justification not to make CMP mandatory.
- It was suggested that the forthcoming database of rogue landlords and letting agents could have a role in enforcement and all agreed national enforcement guidance was necessary.
- A lead authority model, such as for estate agents, could be a consideration.
- At present, fines from enforcement are returned to the local authority and not necessarily used to resource Trading Standards. It would be helpful if the money were ring-fenced.
- If not having CMP were a criminal offence, support was for it to apply to a company director personally rather than the legal entity.
- There is a lack of professionalism in the sector, including a lack of knowledge and understanding about existing requirements.
- Of the 18-20 agents visited by one officer most had only 1 office and just 4 were members of a professional body.
- Trading Standards representatives were of the opinion that too many CMP providers would make mandatory CMP harder to enforce. Trading Standards would need to check against a large pool of bodies and be aware of new providers opening and closing; providers should be Government backed with set standards.
- All agreed that CMP providers should be licensed and that there should be a limited number. It was suggested that the Government could look at existing CMP providers as an indicator of what could/should be included in CMP schemes. Some representatives suggested that 'soft touch' standards would be necessary in order to ensure the majority of agents could meet the criteria.
- The Government/enforcers will also need to be on the alert for phoenix companies.

### **Session 3 – Tenants, Landlords, Charities and Landlord Representative Bodies**

All organisations had previously stated they were in favour of making CMP mandatory so the discussions focused how to achieve this. The main points of the discussion were:

- Landlords and tenants trusted their letting agents and just expected that they were bound by the law.
- Some agents hold large amounts of client money, for example students are often asked for a year's rent in advance. Citizens' Advice reported that in cases where tenants lose their deposits, they can subsequently struggle to afford another rental.
- The rental market does not work like other markets; consumers are limited by geography and the type of property.
- The landlord groups reported that some of their members do not understand the requirements on letting agents or what to do if their agent goes into administration.
- Citizens' Advice estimate that 20% of agents are not signed up to redress schemes, although this is falling.
- The National Landlords Association suggested that agents should be members of professional bodies and then be required to demonstrate membership.
- There should be an expectation for landlords to carry out some basic checks on the agents that they use. The CMP schemes should enable landlords to verify whether an agent has CMP. This service/register could be paid for by the scheme using CMP scheme fees.
- Mandatory CMP would need strong enforcement through Trading Standards or alternatively by the redress schemes. It was suggested that a proportion of the scheme fees could be used to pay for enforcement.
- Fixed penalty notices may be better than prosecutions. Both landlord groups agreed that £5,000 penalty charges were reasonable for failure to comply. With criminal prosecutions there would be questions about who to target. The company director should be liable but there were questions about what would happen when there are franchise arrangements?
- An agreed set of standards was required. There should not be a cap on the number of providers assuming they met the standard as there is only a limited number of companies that understand the market. However, this number may grow over time in the same way that landlord insurance did when it first became available.

- If CMP were mandatory, awareness would increase and people would be more likely to report agents for not having CMP since they would know such practice was unlawful. This would help to cut down on the number of rogue agents.
- Professional bodies may be able to pass on good practice information to consumers, for example through the Government's 'How to rent guide'.

## **Session 4 – Legal and Property Management, Insolvency and Enforcement**

The main points of discussion during session four were:

- Tenants do not consider CMP when choosing a property. The majority of tenant money is tied up in TDP rather than CMP, although there is an element of risk where tenants pay rent via the agent.
- If a letting agent becomes insolvent, deposits that are clearly ring-fenced and protected by a TDP scheme would be returned to the tenant. Advance payment of rent is not currently protected in the same way as deposits unless held in a separate client account. If CMP were made mandatory the insolvency service would provide guidance to say that advance rent should be returned to the client if the agent went bankrupt.
- Sales and letting agents should be a member of a professional body. Membership of a professional body wouldn't necessarily need to be a statutory requirement but could be encouraged through the introduction of an endorsed rating scheme for letting and sales agents with a link in to an industry code and redress schemes. A voluntary approach would leave a small number who don't want to sign up but efforts could be focussed on these – audits, inspections etc.
- Larger agents are generally more professional and as more institutional investors move into the market they are less likely to avoid CMP.
- Looking at other models of protected 'client accounts,' law firm money is protected to a higher standard than letting agents, where the cap is lower.
- There is an important distinction between reimbursement schemes (currently in place) and insurance schemes. Reimbursement schemes are relatively cost effective at around £350 so costs are generally absorbed. If there were a move to an insurance model it may be harder for smaller agents to comply as premiums would be more expensive and agents could end up subsidising poor practice. Smaller agents may struggle to make the sums work. An insurance model would also require different regulation.
- Regarding enforcement, participants in the session felt that there would need to be a clear penalty for any fine not paid and that directors should be held personally accountable. Also there could be some personal liability for insolvency for an agent trading as a sole trader rather than as a part of a

company. Other enforcement suggestions included using the database of banning order offences.

- A primary authority enforcement model should be used; such a model is in place in the estate agent sector with the role of primary authority undertaken by Powys Council. Powys is a prosecuting authority for anti-money laundering and importantly has links with organisations such as HMRC and the Citizen's Advice Bureau. A joined up approach across these organisations supported by a consumer education programme could weed out most non-compliance issues, then resources could be targeted at the real rogues. Powys makes information available to any enforcement body that needs to see it and their banned list of estate agents is publicly available. They are currently looking to incorporate information from the redress schemes.
- A disqualification regime is currently in place and the Secretary of State and official receiver can apply for a disqualification order against unfit directors. Insolvency practitioners are authorised and have a duty to produce reports on the conduct of directors 3 months after failure.
- In order to help detect crime or fraud, it was suggested that there could be a tighter regulation of deposits and how documents are downloaded and returned to member organisations. For example, requiring a second signature or requiring accountants to send off audited accounts directly or making book keepers legally accountable to raise concerns when they occur.
- HM Treasury is consulting on the 4<sup>th</sup> anti-money laundering directive and as part of this has proposed a fit and proper person test for letting agents.
- A question was raised as to whether mandatory CMP should apply to housing associations who act as letting agents since housing associations are already regulated. Similarly, large institutional investors tend to have finance covenants. Exceptions to mandatory CMP may therefore be necessary.

## **Session 5 – Sector Representatives, Insurance Bodies and Recovery Specialists**

The key points from session five of the oral evidence sessions were as follows:

- Mandatory CMP would be welcomed but enforcement is the challenge. It would be difficult to establish how many poor letting agents there are because they operate under the radar.
- Communications is a significant challenge. Membership organisations could be used to contact landlords but there are also a number of 'accidental landlords'. There needs to be a simple message for landlords and general education of letting agent directors and trustees is also needed.
- Government should work with the sector and providers to develop a minimum standard that provides a suitable level of cover. Suggestions of an appropriate

level of cover included deposit money plus a year's rent. Student housing often requires 6-12 months' rent up front and rent money not passed on is likely to be the main claim on a CMP policy.

- It was suggested that providers should be authorised, licensed or approved by the Government. Consideration needs to be given to the number of providers; too many will make enforcement more difficult. Redress schemes would need to share information on agents who have been removed from a CMP scheme.
- Managing agents have a different role to letting agents and so any regulations would need to be different in their application to them. A resident management company could be handling millions of pounds.
- CMP providers should be required to make their registers searchable, in the same way that tenancy deposit protection scheme providers do, so that landlords and tenants can check whether an agent has CMP. Landlords should also be able to sign up for a service that notifies when an agent withdraws CMP cover or does not renew.
- Sharing information is problematic because of data protection issues (including HMRC) but some information is already shared with Trading Standards and other law enforcement agencies/regulators. There is a need for a better two way relationship and there is a requirement to raise the profile of Trading Standards as the enforcer.
- A lead enforcer would keep things simple and be a central resource to collate information if faced with multiple providers. The level of fines should be proportionate to the size of the organisation.
- If CMP were made mandatory it will be important to ensure that accountants understand audit requirements.
- Standard corporate and trust law requires specialists to deal with client accounts separately. Banks would expect to levy a small charge for setting up trust accounts. Money held in a legally binding client account (designated as a trust or client account) would be protected from liquidators/administrators in the case of an agent declaring bankruptcy. Issues arise when the money is not properly accounted for or not enough money is in the account. Currently, some banks will not allow access to client accounts or confirm separate client accounts since there is no statutory duty to do so.
- CMP cover that is managed by insurance brokers tends to require membership of a professional body or a redress scheme. Their requirements include fulfilment of membership criteria, on the spot auditing, provision of audited accounts and audit checks etc. Individuals not operating as a corporate business are a harder risk to underwrite. Currently, there is a soft market and many insurers are competing for business and there may not be a direct correlation between risk and price. A large number of letting agents not linked to an affiliated membership body would be seen as higher risk.

- Some insurers would not look at individual policies for sole traders and would want all clients to be part of a membership body in order to be eligible for cover since it would be less risky for insurers. However, there could be cover outside of membership bodies although the prices would increase since insurers would have to cover the administrative costs of ascertaining risk, managing it, policing and enforcing etc.

## **Session 6 – Banks, Housing Associations and Insurance Provider**

A summary of the main points of the discussion in the sixth oral evidence session is below:

- Where a letting agent is regulated and operating a client account the bank can rely on separate due diligence having taken place by the professional body of which the agent is a member. However, banks are still duty bound to undertake additional due diligence.
- If someone was intent on misappropriating funds they could instruct the bank to transfer money from a client account. Indemnity insurance would be needed for full coverage.
- If the law was to remain as it is, the banks can only open a client account for the deposit and service charge. The current framework would need to be extended to incorporate rent monies.
- Banks require letting agents to provide details on the account beneficiary. Letting agents should be able to confirm due diligence. The bank will sometimes refuse to open a client account if the property manager cannot be clear about the beneficiary.
- HM Treasury's anti-money laundering (AML) legislation does not currently apply to letting agents, but HM Treasury is considering whether the legislation should be extended. AML fines are substantial, which makes the banking industry cautious. Banks may choose not to take letting agent business if deemed too high risk.
- Attendees at the session felt that property managers and letting agents should be brought into the AML framework. Some property manager services are covered by AML, for example they could be considered an accountancy service provider if they provide regular accounts or payroll updates, but there is some confusion within the sector as to what is required.
- Bank practice is based on strict interpretation of AML regulations and HMT guidance. If CMP were made mandatory, banks would expect to take a risk based approach. Extra checks would be required if not a UK bank/client.
- Housing associations (HAs) have very limited engagement with letting agents. The National Housing Federation is not aware of any HAs acting as letting agents. However, housing associations that operate market rent housing as

part of their social housing development might take on a letting/management agent function. Consideration needs to be given as to whether HAs would/should be caught by mandatory CMP requirements. HAs would be interested in the financial relationship between the registered and non-regulated body for stress testing financial viability and governance rather than consumer protection.

- Lonsdale's experience is of confusion in the sector and that trade bodies have made it difficult for other parties to offer CMP. Their CMP scheme is exclusive to members of the Property Ombudsman and agents have to abide by a code of conduct and have professional indemnity insurance in order to be eligible for CMP cover. Under Lonsdale's scheme, if a letting agent becomes insolvent the consumer claims back via the Property Ombudsman and insurance provider.
- Lonsdale spot checks client accounts and require assurance that the letting agent has sufficient knowledge and experience (a minimum of three years) to operate. Applications are refused if they cannot meet the relevant criteria. Premiums are set according to average claim loss but this approach could be tailored. An upsurge in applications would not be problematic.
- Lack of regulation of letting agents in England is problematic – guidelines with minimum criteria/qualifications for letting agents were recommended. If CMP were made mandatory, new entrants to the market would need to prove they knew what they were doing for example, through relevant work experience, or formal qualifications, and their business plan would need to be examined.

## Annex E – Case Studies

### Case Study 1 – Case of Williams & Young<sup>2</sup>

Between May 1, 2013, and July 17, 2015, Amy Williams syphoned off more than £408,800 from the company's account, and paid it into her boyfriend's bank account who used it to fuel a gambling habit.

When company funds began to run low, Ms Williams started defrauding tenants directly, taking deposits and advanced rent. She also took money from different people for the same properties. After pocketing deposits and advance rent, people were left homeless. In one case involving a city centre flat, 12 victims were defrauded. Nine landlords were also 'systematically defrauded'. In some cases landlords were unaware that the money had not been passed on.

### Case Study 2 – Whitefield Properties<sup>3</sup>

David Whitefield stole £123,000 from dozens of property landlords. Mr Whitefield pocketed rent and deposits paid by tenants rather than passing on the cash to his clients over four years. During this time he put tenants' rent and deposits in the company's 'working capital' account.

An investigation found that David Whitefield had made 1,200 payments into the 'working capital' account. The company collapsed into administration in 2014, owing more than £198,000. One landlord was owed £900 in rent that has never been paid.

### Case Study 3 - Dorset Lettings<sup>4</sup>

Dorset Lettings North was a franchised lettings agency in Shaftesbury that went into liquidation in 2013. At the time of liquidation there were 258 tenancies with a deposit value of nearly £275,000. There were no monies in the client account. In total £375,000 was missing.

The owner, Janine Pickett, stole monies from the client account and she was eventually successfully prosecuted for fraud by abuse of position. The situation caused much stress and worry for staff, landlords, tenants and suppliers. However, because the organisation had CMP cover and had protected tenant deposits via a tenancy deposit scheme, landlords and tenants were able to recoup their losses.

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<sup>2</sup> <http://www.birminghammail.co.uk/news/midlands-news/couple-left-clients-homeless-used-11228825>

<sup>3</sup> <http://www.stokesentinel.co.uk/fraudster-kept-123k-owed-landlords/story-29034542-detail/story.html#ixzz4418fX8eS>

<sup>4</sup> <http://www.bbc.co.uk/news/uk-england-dorset-30576212>

#### Case Study 4 - Roy Jackson<sup>5</sup>

Roy Jackson stole £70,000 from his customers and failed to give dozens of landlords' cash which they were owed. The fraud took place between January 1, 2011 and January 20, 2013. Local police reported that around 30 landlords, some with more than one property, had reported that they had not received the money owing to them. In total, the investigation included 48 properties.

#### Case Study 5 – A landlord's experience

One landlord lost £4,000 from an agent who did not have Client Money Protection. The agent had insisted on three years fees up front but never paid the landlord her money consistently. The landlord now does not use an agent for her properties. The landlord was not aware of CMP when she chose the agent; she chose them because it was local and she wanted to have a relationship with them. The landlord knew that the letting agent was a member of an ombudsman scheme but was not aware that this did not cover CMP.

#### Case Study 6 – A landlord's experience

'I myself have been a victim of an unscrupulous letting agent handling my money wrongly without any apparent concern of the consequences. As well as withholding rent that was due to me the agent also did not lodge tenant deposits received into deposit protection schemes as they were entrusted to. This left me as a landlord not only thousands of pounds out of pocket for rental income. It also made me liable for the tenant's deposits even though I had not even taken this money.

Any legislation that will make letting agents think harder before adopting such an irresponsible attitude is a good thing. I'm sure not all letting agents who end up mishandling clients' money set out to do so from the beginning. However things don't always go to plan and unforeseen problems can arise. With better legislation to protect money which is rightfully the landlord's this would go a long way to ensure that agents think harder before taking business risks which jeopardise things.'

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<sup>5</sup>[http://www.ipswichstar.co.uk/news/suffolk\\_letting\\_agent\\_roy\\_jackson\\_faces\\_jail\\_after\\_admitting\\_embezzling\\_around\\_70k\\_from\\_clients\\_1\\_383074](http://www.ipswichstar.co.uk/news/suffolk_letting_agent_roy_jackson_faces_jail_after_admitting_embezzling_around_70k_from_clients_1_383074)