OFFICE OF FAIR TRADING

Annexes

Competition in markets with commission rates

Five UK case studies

Prepared for the OFT by DotEcon Ltd

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CONTENTS

This report is based on information from published reports and papers gathered by DotEcon up to and including the end of July 2006. All references to 'current', 'recent' etc relate to the same timeframe. This report also includes information provided to DotEcon by third parties (up to and including the end of September 2006). DotEcon has not independently audited or verified the factual accuracy of any of this information.

The use of the word 'market' within these annexes does not in any instance refer to a market as defined for competition law purposes, and should instead be read as in its generic form.

A RESIDENTIAL SALES ESTATE AGENCY

A.1 Estate agents play a key role in the UK property market, with residential sales alone having yielded approximately £3.7 billion in agents' fees in 2004.[1] Agents range from national and regional chains through to local and specialist companies, with approximately 11,000 estate agent offices in England and Wales as of 2004.[2] Commission payments are a common feature of the market with rates generally calculated as a percentage of the final transaction value and charged to the seller of the property.

Understanding the sector

A.2 UK residential property market transactions cover the sale or letting of residential properties. In this case study we focus on the largest of these categories: residential property sales in England and Wales, where estate agents are charged with brokering property transactions. We have excluded the consideration of property transactions in Scotland where there is a more substantial role for solicitors in property sales. Residential sales account for approximately 70.5 per cent of estate agent revenues, with fees from mortgage and insurance sales being the second largest component (accounting for 25.3 per cent).[3] We have excluded letting services as commission rates are more prevalent in sales. Residential lettings account for less than 2.4 per cent of the total and in most cases residential sales and letting businesses are separated within agencies.

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[1] Source: 'Market Assessment on Estate Agents and Services', Key Note, September 2004.

[2] Ibid.

[3] Source: 'Market Report on Estate Agents', Key Note, August 2004.

Market size

A.3 The demand for agency services is directly related to activity in the property market; the overall volume of estate agents' residential property sales business varies with the total volume and value of property transactions:

- between 1998 and 2002, there was an increase in the number of residential property transactions in England and Wales of approximately 19 per cent, from 1.22 to 1.45 million.[4] The number of transactions rose further to 1.5 million in 2003[5] and 1.7 million in 2004[6]

- the value of properties has increased substantially over the same period. The average house price in England and Wales was £164k in quarter four of 2003.[7] By quarter one of 2006, the average cost of a house in the UK had risen to £193k,[8,9] with the value of the UK housing stock representing over half of total household wealth.[10]

A.4 Estate agents' revenue from the sale of residential property in England and Wales in 2002 was over £2.5 billion.[11] By 2004, residential sales yield had increased to £3.7 billion in agents' fees.

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[4] Source: 'Market Study of Estate Agents in England and Wales', OFT, March 2004.

[5] Source: 'Market Report on Estate Agents', Key Note, August 2004.

[6] Source: 'Market Assessment on Estate Agents and Services', Key Note September 2004.

[7] Source: 'Market Study of Estate Agents in England and Wales', OFT, March 2004.

[8] Source: BBC website, data from the Land Registry of England and Wales, the Registers of Scotland Executive Agency and the University of Ulster.

[9] Given that the residential housing market in Scotland faces similar price trends as that of England and Wales, this reflects a substantial increase in residential property value over this time.

[10] Source: 'Market Assessment on Estate Agents and Services', Key Note, September 2004.

[11] Source: 'Market Study of Estate Agents in England and Wales', OFT, March 2004.

A.5 Within the overall trend, there is considerable regional variation with a much higher volume of business and higher sales values in some parts of the country. In particular, while transactions in London and the South East represented 31 per cent of the total number of residential property transactions in England and Wales in 2002, these areas represented 46 per cent of residential property sales by value over the same period.[12] This region has also been subject to larger than average increases in property value; the average cost of a home in the capital first breached the £100k mark in the second quarter of 1996, passing the £200k mark between April and June 2001 and has now exceeded £300k.

A.6 However, the market is characterised by considerable fluctuations in the number of annual property transactions. For England and Wales, a three per cent fall in 2000 was followed by a 1.2 per cent rise in 2001 and then an eight per cent rise in 2002, according to Inland Revenue figures. The value of transactions changed from a small rise of 4.1 per cent in 2000 to a 19 per cent rise in 2001 and a further 20 per cent rise in 2002.

Understanding buyers

A.7 Buyers generally seek the assistance of multiple agents in their search for a property - looking to agents to provide information on suitable properties on the market, advice on other services such as mortgages and help with coordinating the completion of the sale by liaising with the buyer, the seller and their respective solicitors once their offer is accepted by the seller.

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[12] Ibid.

A.8 The OFT market study noted that two thirds of respondents to their survey registered with approximately five agents. Moreover, '[t]he higher the value of the property sought, the greater the number of agents registered with. Those looking for a property value at:

- less than £60,000- registered with an average of four estate agents
- between £60,001 - £150,000 – registered with an average of 4.9
- more than £150,000 – registered with an average of 5.9'.[13]

A.9 Although 95 per cent of buyers located their eventual purchase through an agent's direction, buyers also use other search methods including advertising in local newspapers and magazines, touring local areas for 'For Sale' signs and searching on the internet. Indeed, the growth in use of the internet by potential buyers in recent years has led to the growth of estate agencies providing property portals. The OFT survey of recent buyers found that 37 per cent of respondents had searched the internet for properties for sale, although only nine per cent found the house that they eventually bought as the result of an internet search.

A.10 Property search still consumes a substantial amount of time for those looking to buy a house. A survey of home buyers carried out for the Department of the Environment, Transport and the Regions in 1998 revealed that much of the time taken to buy a home was spent finding the right property. Typically, this took about 67 days (median), although the mean period for all respondents was roughly twice as long at 136 days. Almost a

[13] Ibid.

quarter (23 per cent) of buyers took six months or more to find their new home.

A.11 The information held by buyers that is relevant to their search is their willingness to pay, their requirements for the desired property (such as location, number of bedrooms or any special needs) and the weightings that they ascribe to each of these requirements.

Understanding sellers

A.12 The OFT market study noted that nearly all sellers (94 per cent) completed the sale of their property via an agent – with sellers looking to agents for advice on the valuation of their property, showing potential buyers around the property and assisting as necessary during the completion of the transaction. The main focus of sellers is their net gain upon sale that is, the amount the seller receives on sale of the property less the cost of sale which generally includes agency costs.

A.13 The OFT noted that 95 per cent of sellers initially signed up with just one agent, choosing the agent based on a number of factors, namely:

- reputation/recommendation
- size of fees
- professionalism of the staff
- proximity to own property (majority choosing an agent within five miles of their property), and
- past experiences.

A.14 A Key Note survey noted that most respondents did not appear concerned whether they go to a local or national agent, though a large proportion (41 per cent) preferred to engage a local agent, whilst only a minority (six per cent) expressed a preference for using a national agent.[14]

A.15 The OFT found that the average length of time from marketing to completion of the sale of a property was 4.7 months, with completion of the sale taking on average about 3.1 months. Those sellers who signed up with more than one agent did so to expedite their sale, although the OFT report noted that having more than one agent did not lead to a quicker sales (with the whole process taking an average of nearly six months). The OFT noted that 'there was also a correlation between the value of the house and the time taken to sell it; the more expensive the property, the longer it took from marketing to completion of the sale'.

Role of agents

A.16 The estate agency sector in England and Wales is composed of four main groupings:

- national agents selling and letting exclusive, expensive properties to an international clientele
- mass-market national agents, headed by the largest agencies Countrywide and Connells
- mass-market regional agents, such as Kinleigh Folkard and Hayward and Arun Estates, and
- smaller independents, with local to regional coverage.

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[14] Source: 'Market Assessment on Estate Agents and Services', Key Note, September 2004.

A.17 The main role of the agent as intermediary is to match buyers and sellers. However, agents provide a range of other services, noted in order of importance by an agency survey for the OFT. These are set out in

Table :

Table A.1 - Services provided by estate agents

Services to sellers	Services to buyers
Chasing solicitors	Accompanying viewings
Overseeing the progress of the transaction	Chasing solicitors
Checking buyers' financial status	Handling/negotiating offers
Advising on letting as alternative to sale	Overseeing transactions
Management of rented property	Residential lettings
Guidance on financial services	Mortgage and financial advice
Providing surveys or valuations for associated purchase	Property management
House sales by auction	Holiday letting
Auctions of moveable property	

Source: 'Market study survey'; OFT 2004.

A.18 Estate agency staff spend time on the following activities:

- making an initial visit to undertake a market appraisal and advise the potential client on a price at which to market the property

- once contracted by the client, taking room measurements and other details and taking photographs for the property particulars

- producing and circulating property particulars and contacting buyers listed with the agent with a potential interest

- arranging and attending viewings, and

- handling offers received on properties, and liaising with clients, buyers' solicitors and others.

A.19 In addition to these services, both buyers and sellers regard advising on valuation as an important service provided by estate agents: 79 per cent of sellers surveyed by the OFT expected the estate agent to value the property while 49 per cent of first-time buyers and 42 per cent of experienced buyers expected advice on the amount to offer for the property. Property valuation often has a greater influence on the revenues likely to be earned by the agent than the commission rate charged.

A.20 There is generally a high level of satisfaction with this function among both buyers and sellers; 80 per cent of sellers thought that their estate agent had estimated the value of their house accurately, with the average final selling price being around 98.3 per cent of the initial valuation. When buyers had found the property they were eventually going to buy, 61 per cent of buyers did not seek any advice on what to offer and of those that did, only 18 per cent sought this advice from the estate agent. Paired with the high levels of accuracy in valuation estimates, this suggests that buyers place a high emphasis on the asking price and do not risk losing properties to other prospective buyers by placing an offer significantly lower than the asking price. This reinforces the importance of the estate agent role in setting a selling price.

A.21 The OFT's business survey noted that there can be considerable variation between the values placed on a particular property by different estate agents. This suggests that estate agents may vary significantly in terms of their ability to achieve a higher price for a given property, and agents who believe they can achieve a higher price can charge a higher commission rate to the seller since the seller often gains more from a higher price than it loses in the form of a higher commission.

A.22 Estate agents offer property sellers four types of agreements:

- sole agency, where the seller entrusts the sale of his or her property to just one estate agency
- joint sole agency, where two agents together have the exclusive right to sell the property
- multiple agency, where the agency agreement allows the vendor to sell the property through a number of agencies, usually three or four, and
- sole selling rights, giving the estate agent exclusive rights to sell the property (with a fee being incurred whether or not the introduction is via the agent).

A.23 The majority of contracts are on a sole agency basis; of the respondents to the OFT sellers survey, three quarters had a sole agency contract. A further 15 per cent had a contract giving the agent sole selling rights (generally introduced to protect the interests of an agent engaging in significant marketing of the property) and only three per cent had a multiple agency contract.[15] The average fee rates for sole agency agreements and sole selling rights are generally lower than for multiple agency agreements.

A.24 For sole agency agreements, the lengths of such contracts vary. For 45 per cent, the contract was less than three months, for 25 per cent it was between three and six months and, in six per cent of cases, more than six months. Nearly a quarter of respondents did not know the length of the contract.[16]

Main market players

A.25 The estate agency market is characterised by a relatively small number of large players and many smaller players. Most of the large estate agency chains are owned by larger holding companies which also own a myriad of other companies. Countrywide is the largest market player by a sizeable margin. The following is a list of the top 10 estate agencies by number of offices as of January 2006:

Table A.1 – estate agency offices

Estate Agency	No. of offices
Countrywide PLC	1212
Connells	488
Lending Solutions (Your Move/Reeds Raines)	397
Halifax Estate Agency	332
Spicerhaart	232
Arun Estates	121
Savills	60

[15] Source: 'Market Study of Estate Agents in England and Wales', OFT, March 2004.
[16] Ibid.

Winkworth	61
Kingleigh Folkard & Hayward	66
Hamptons International	56

Source: 'Estate Agency News'; Estate Agency News 2006.

A.26 A number of the largest estate agency chains are owned by financial institutions. In 2002, seven of the top 10 estate agency businesses (which together owned over 20 per cent of the estimated total estate agency branches in the UK) were owned by financial institutions. These groups have grown mainly by acquisition of local firms of estate agents, which often continue to trade under their existing name.

A.27 The level of concentration in the estate agency sector has increased significantly since 2002, with further merger and acquisition activity amongst the largest organisations. For example, in 2005 Lending Solutions (the holding company of Your Move, which was the fifth largest estate agency in terms of number of offices in 2004), acquired Reeds Rains, the seventh largest. As a result, the firm became the third largest estate agency group in the UK.

A.28 Competition between agents takes place at a very local level, with 87 per cent of sellers choosing an agent located within five miles of their property. According to the OFT's survey of recent house sellers in 2003, the average distance between the estate agent's office and the property was 2.6 miles. Estate agents that responded to the OFT's estate agents' survey carried out at the same time considered that they typically had ten competitors with their furthest competitor on average only four miles away.

A.29 Overall, however, this market is not highly concentrated, and there are healthy overall levels of entry and exit. Indeed, a study conducted by NERA as an input to the OFT's 2004 market study found that in six case study localities,[17] no more than half of estate agency businesses survived a full 10 year period.[18] With relatively low upfront capital requirements, and in the absence of any licensing requirements or need for any formal qualifications, it is fairly straightforward to set up an estate agency office. However, the OFT noted that it can take time to build up a reputation which means that hit and run entry is not generally seen.[19]

Range of products and services provided

A.30 As noted above, in addition to the role of matching buyers and sellers, many estate agents offer a range of other services including conveyancing, valuations and surveys and the sale of properties by auction; the OFT's business survey found that more than half of estate agents also provide other services, listing services such as mortgage and financial advice and property management. Many estate agents also provide home letting services.

A.31 Estate agencies also provide an effective distribution channel for financial products; 29 per cent of respondents to the OFT buyers survey were offered financial advice by the estate agent (to be supplied by their own mortgage lending division or another company within the same company group), of which about a third subsequently obtained financial products from the recommended sources.

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[17] In their study, NERA analysed competition in service provision in Cardiff (south west Cardiff), Coventry, Leeds (Harehills), London (Balham), the villages around Northwich, and Winchester.

[18] Source: 'Market Assessment on Estate Agents and Services', Key Note, September 2004.

[19] Source: 'Market Study of Estate Agents in England and Wales', OFT, March 2004.

A.32 The Key Note Estate Agents Market Report (2003) estimated the value of services provided by estate agents in addition to their residential sales service in the UK to be £1.5 billion in 2002. Nearly 90 per cent of this value was accounted for by fees from sales of financial products.[20]

Use of commission rates

Current charging structures and levels

A.33 Fees are usually due on exchange of contracts but paid on completion of a sale. Estate agents' fees are typically set as a fixed percentage of the realised sale value of the property. There is limited evidence of agents breaking away from this pricing structure. A very small proportion of estate agents charge a flat fee. Many agents charge a minimum fee for lower priced properties. There is currently limited variation in fee rates across regions.

A.34 The survey of sellers undertaken by the OFT in its 2004 market study indicated an average fee paid of 1.45 per cent. However, there is variation in the percentage fee rates charged. The OFT noted widespread use of 'pricing points', with the vast majority of fees being set at about one per cent, 1.25 per cent, 1.5 per cent, 1.75 per cent or two per cent. The highest fees were in the South East and Wales.

A.35 The Key Note market research report also noted similar fee rates.

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[20] Ibid.

Table A.2 - typical fees by type of contract

Estate Agent Agreements by Typical Fee (per cent), 2003	
Sole agency	1.5 to 2.0
Joint sole agency	2.0 to 3.0
Multiple agency	2.5 to 4.0

Source: 'Market Report on Estate Agents'; Key Note, August 2004.

A.36 Alternative ranges are, however, emerging in the on-line arena. An on-line agent halfapercent.com is offering commission rates of as low as 0.5 per cent, although at this low rate viewings of the property are conducted by the buyer alone (without an agent).

A.37 The OFT also noted that there is no significant difference in average fee rates across different property price bands (which of course means that, in absolute terms, fees on higher priced properties were proportionately higher).

Table A.3 - average fees by property price band

Price band	Average fees paid per cent	Average fees paid £
Less than £100k	1.64	1,095
100k to under £200k	1.40	2,032
£200k to under £300k	1.40	3,414
£300k or over	1.35	5,609
Total	1.45	2,525

Source: 'Estate Agency Market in England and Wales'; OFT, March 2004.

A.38 Flat fees were employed in very few of the cases, although 20 per cent of respondents to the OFT agent survey suggested that they charge a minimum fee for handling cheaper properties.

A.39 The OFT study noted that almost two thirds of all sellers (61 per cent) claimed to shop around before choosing an estate agent, with 90 per cent doing so by comparing the fees between agents. Nearly half (49 per cent) of all house sellers claimed to have tried to negotiate fees with their chosen agent. Interestingly, the study noted that although the greater the value of the property the less likely the seller was to shop around for quotes, those selling the most expensive properties were the most likely to attempt to negotiate fees.[21] Of those who attempted to negotiate fees, 79 per cent were successful. In approximately half (47 per cent) of all cases where a seller claimed to have managed to reduce their agent's fees, the reduction was 0.5 per cent or greater.

A.40 Estate agents use a commission structure internally also to incentivise their staff. Individual agents have a relatively low basic wage and the sales commissions represent a large proportion of their total income. While the specifics of remuneration structures can vary amongst firms, they are mainly linked to the volume of sales made, whether directly through flat fees or a commission rate per sale or indirectly through consistent meeting of sales targets linked to cash bonuses or benefits.

Historic charging structures and levels

A.41 The volume of residential property sales fluctuates significantly with the property cycle and on a seasonal basis, with the second quarter traditionally having been the peak sales period. According to a large market player, commission charges do reflect market conditions, with agents' commission rates moving counter-

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[21] Fifty seven per cent of those with a property valued at over £150k tried to negotiate compared to only 31 per cent of those with a property valued at under £60k.

cyclically; when the economy is in recession, agents increase commission rates, recognising that they will need to devote a greater level of resources to completing a sale. This seems to suggest that charges reflect costs in times of recession, though the OFT have noted estate agents' reluctance to reduce fees in boom times.

A.42 In their competitive analysis of the provision of estate agency services for the OFT market study, NERA found evidence of rigidity of fee setting over time, with fees as a percentage of property value tending not to adjust quickly to movements in property values. The NERA study also noted that absolute fees have fluctuated with the housing cycle in a way that is not explained by movements in cost.

A.43 Relating to changes in charging structure over time, a market player reported that until now this has happened only on a small scale and has been transient, with the current charging structure ultimately prevailing, based on consumer sentiment regarding these alternatives. More specifically, flat fees in the form of registration fees and transaction fees (that is, £295 registration fee, £1000 fee for the sale of the property on a sole selling rights basis) have emerged and subsequently been withdrawn from the market for two reasons:

- there is a negative sentiment towards paying for the service regardless of whether a sale takes place, and
- payment in advance can have the effect of generating inertia within the agent to complete the transaction.

A.44 Moreover, where commission rates have been introduced in areas where flat fees in advance have previously been prevalent, there has been a shift in the area overall towards commission rates. This has been due to the swift gain in market share of firms introducing commission rates, and has caused other firms in the area to react by also introducing commission rates.

A.45 A stakeholder noted that commission rates in estate agency have emerged following the failure of alternative charging structures historically (for example, separate charges for number of ads, for-sale boards, facilitation) and sellers preferring no-sale-no-fee policies and the payment of a single fee for the various activities being undertaken by the agent. Percentage commission rates are also seen to be simplifying the task of comparing agents' offers relative to other potential remuneration structures. Together, these factors have been taken to explain the rationale for the widespread and prolonged use of percentage commission rates amongst estate agents.

B FINANCIAL ADVISORY SERVICES

B.1 Financial advisers (FAs) provide advice to clients on the many financial products available, and are paid for this service either through fees from the buyer, commissions from the seller (for whom they perform the role of a distributor), or a combination of the two.[22]

B.2 Prior to changes in legislation in December 2004, FAs could either be independent (IFAs), in which case they were required to offer advice on the products of all product providers in the market, or tied to a single product provider (tied FAs), offering only that provider's products. Today, FAs also have the option to offer products from a range of providers (multi-tied FAs).

B.3 As the largest distribution channel for financial products, IFAs play a significant role in the financial products market. Being independent means they are obliged to provide unbiased advice on the most suitable products for the customer from the entire market. However, the use of commission rates as a form of adviser remuneration has for many years sparked debate over whether or not the advice of IFAs is biased toward certain products or product providers, and whether a fees based remuneration structure might be more appropriate.

Understanding the sector

Legislation in the financial advice market

B.4 Before the introduction of polarisation in 1987, financial advisers fell into one of three broad categories:

- agents of insurance companies

[22] The seller is the provider of the financial product whereas the buyer is the customer seeking advice from and potentially purchasing the product through a financial adviser.

- insurance brokers, or
- firms paid through commission to introduce new business to a small number of providers.[23]

B.5 At this time there were no rules or precise definitions covering the issue of independent advice and the situation resulted in a number of advisers operating under the guise of independence when in reality offering products of a few providers only. The polarisation regime was introduced to increase accountability and clarify adviser status. The rules applied to advice on packaged investment products,[24] and required that financial advisers operate as either an independent agent covering the whole of the market,[25] or as a tied adviser working for just one product provider.

B.6 Some IFAs are owned by banks and building societies, and to prevent bias towards the distribution of in-house products the 'better than best' rule was introduced with polarisation requiring that if a provider owned more than 10 per cent of an IFA firm the adviser could not recommend the products of that provider unless it was able to demonstrate that the product was better than any other product of the same type in the market.

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[23] Source: 'Polarisation and Financial services Intermediary Regulation', London Economics report for the FSA, July 2000.

[24] Packaged investment products include life policies, personal pensions, collective investment schemes, and investment trust savings schemes.

[25] Note that this does not require IFAs to offer advice on all product types. They may specialise in certain areas but where advice is provided it must be for the most suitable product in the market.

B.7 Tied advisers could be tied to a single provider or to two or more firms that make up a marketing group, and may be appointed representatives of a product provider or company representatives employed by the providers.

B.8 Following criticism by the Director General of Fair Trading about the potentially restrictive and distortive effects of polarisation on competition,[26] the FSA consulted on potential changes to the regime, and in December 2004 introduced the depolarisation legislation. FA firms are now able to operate as independent advisers, tied agents, or multi-tied agents who offer products from a panel of providers.

B.9 As a result of the legislation, financial advisers must provide customers with two key facts documents:

- the initial disclosure document (IDD) which provides an explanation of the services offered by the adviser and the status under which it operates (independent, tied, multi-tied etc), and

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[26] The main issue raised by the DGFT was that the polarisation regime restricted innovation in the financial services sector to models that were compatible with the permissible business models, and thus restricted or distorted competition. There were also concerns about the ability of product providers not currently in the market to launch services, as they would not be able to distribute their products through tied agents. These restrictions were outweighed in the of case life assurance and personal pensions by the competition between providers generated by the number of (independent) advisers in the market and the benefits to consumers from the protection of their interests created by these rules. However, the DGFT did not consider that the latter effects were sufficiently strong to outweigh the restrictive effects in the case of collective investment schemes (e.g. unit trusts), see 'The Rules on the Polarisation of Investment Advice', A report by the Director General of Fair Trading, August 1999). The FSA commissioned London Economics to evaluate the restrictive effects and to establish alternatives to the polarisation regime, and consulted on changes to the system in January 2001 (see 'Reforming Polarisation: First Steps', FSA Consultation Paper CP80, January 2001, the findings of the London Economics study are summarised below).

- the menu which gives an explanation of the costs of the advisers services. It will show the customer how the advice can be paid for and gives the typical fees or maximum level of commission that the adviser can charge. If part or all of the charges are paid by commission the adviser must also include a market average commission figure as calculated by the FSA.

B.10 Independent advisers must also give their customers the option to pay for advice through fees alone, although advisers can continue to operate on a whole market basis without offering this option provided they do not classify themselves as independent. Under the new rules financial advisers may also be dual-authorised which allows them to act as multi-tied advisers choosing products from a predetermined range of providers, but also to search the entire market if a suitable product is not available from their panel. Another feature of the legislation is that the 'better than best' rule has been abolished, allowing providers to invest in IFAs without reducing the ability of the adviser to offer advice on their products.

B.11 Although it is possibly too early for an accurate assessment of the effects of the depolarisation legislation, Datamonitor has looked at the post depolarisation market and made a number of observations and predictions.[27]

B.12 Datamonitor finds that the shift towards multi-tie has been minimal. In the second quarter of 2005, few IFAs said they were

[27] Source: 'UK IFAs 2005', Datamonitor, January 2006.

willing to give up their independent status,[28] particularly when it would involve changing from a business model that they know to work to one that has not yet been tested in the market and at the time did not have any clear strategies and proposals. Some IFAs also felt that the increased regulatory paperwork required would not be the best way to begin a relationship based on trust with the customer.

B.13 This negative feeling towards multi-tie is reflected in the low number of both IFAs and tied advisers changing status in the year after depolarisation. Indeed, since polarisation was introduced IFAs have strengthened their position in the market with the level of demand for independent advice increasing. However, Datamonitor expects the number of multi-tied agents to grow over the next five years once the model has proven to be commercially viable and the level of support from providers becomes clear.

B.14 The providers who have benefited from the introduction of multi-ties are those who are strong across all product areas. These are attractive to multi-tied agents as they are the most likely to provide a suitable product for the customer and using just a few of these firms means that the adviser has fewer relationships to manage than if they had a panel including a large number of specialist firms.

B.15 Niche providers are not doing as well as Datamonitor expected, with most multi-ties opting for the 'waterfront' (panel of large premier league providers) approach and the smaller firms are finding it difficult to get selected for adviser panels.

B.16 The impact on remuneration for most IFAs has also been limited, despite the introduction of the obligation to provide

[28] Of 102 IFAs surveyed by Datamonitor in the second quarter of 2005, 100 said that they would remain independent, the main reason being the desire to keep the independent status (source: 'UK IFAs 2005', Datamonitor, January 2006).

buyers with an option of paying by fees. There are concerns that some IFAs have failed to properly embed the fee based model in their business, for example by charging high fees in order to encourage customers to accept the commission charges, but independent advisers generally feel that the low use of the fee based model is due to the fact that consumers prefer to pay by commission.

B.17 The highest take up of fee-based payments is likely to be in specialist and high net worth ends of the market where independence of advice is more important, and clients are more likely to pay by fee to avoid commission bias. It is in these parts of the market that the fee approach has managed to gain ground so far.

B.18 Financial advisers themselves appear to have mixed views on the likely efficacy of the legislation in increasing fee transparency in the market. In a Datamonitor 2005 survey, 73 per cent of advisers believed it had no impact on fee transparency, 17 per cent saw a negative impact and 10 per cent a positive impact.

Market size

B.19 The range of financial products distributed through FAs can be split into three broad categories:[29]

- life products such as life based savings products and life assurance. These can be segmented further into single premium and regular premium products[30]

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[29] These categories are those defined in 'UK IFAs 2005', Datamonitor, January 2006. There are many ways to divide the market. However, these categories are used for convenience as market data is also drawn from this Datamonitor report.

- pensions products such as personal pensions, stakeholder pensions, and group personal pensions. These can also be split into single premium and regular premium products, and

- retail investments such as unit trusts and open ended investment companies (OEICs).

These financial products are distributed through a number of channels including IFAs, bancassurance, tied agents, directs sales forces, and through direct contact between customers and providers and fund managers without the use of an intermediary.[31]

B.20 Since 2001 IFAs have accounted for more than 63 per cent of sales in the total life[32] and pensions[33] market and in 2004 this figure was 67.6 per cent of the £6.1 billion worth of new business life and pensions sales. Approximately £2.4 billion came from the pensions market and £1.8 billion from the sale of life products, giving a total sales value of £4.1 billion. In comparison,

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[30] Single premium products are paid for by the customer in a single lump sum. Examples include with-profits bonds and purchased life annuities. Regular premium products are paid for in recurring instalments over the term of the policy at intervals specified by the policy. Regular premium products include whole of life insurance and term assurance. Pensions can usually be paid for either in a single premium or in regular premiums.

[31] Bancassurance is 'the selling of insurance policies by banks and building societies, through wholly-owned subsidiary companies of these, rather than by insurance companies' (source: Allwords.com), and direct sales forces work for a life office on an employed or self-employed basis and only sell the products of that provider company (source Datamonitor 2005).

[32] Between 2000 and 2004 sales of all life products declined by a compound annual rate of 3.8 per cent, although an upturn in 2004 (driven mostly by a recovery in single premium products) ended the slump.

[33] Total pensions sales on rose by a compound annual rate of 5.3 per cent between 2000 and 2004. Sales of regular premium pensions have accounted for an average of 67.8 per cent of total pensions sales over that period, though sales of single premium products have been growing at a faster rate.

tied agents generated only £214 million worth of sales in the total life and pensions market, giving them a share of 3.5 per cent. Bancassurers, the second largest of the distribution channels, have gained ground over the last five years with a compound annual increase in sales of 8.5 per cent, compared to 3.3 per cent for IFAs, and in 2004 had a 13.9 per cent share of the life and pensions market. Direct sales forces have experienced a decline in share for life and pensions products due mainly to cost related cutbacks in their size, and their share of 25.5 per cent in 2000 fell to just eight per cent in 2004.[34]

B.21 IFAs are also the most significant channel in the unit trust and OIEC market.[35] Between 2000 and 2004 they consistently held a share of greater than 60 per cent, and accounted for 72 per cent of sales in 2004 after an increase in turnover of £3.9 billion to £21.7 billion between 2003 and 2004.[36]

B.22 Datamonitor suggest that the main reasons for IFAs acting as such a major sales channel appear to be a lack of effective competition from other distribution channels and the demand from consumers for independent advice.[37]

B.23 Turnover achieved by IFAs is increasing despite a fall in the number of firms. In the period 2003 to 2005 the total turnover of

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[34] Source for all information in this paragraph: 'UK IFAs 2005', Datamonitor, January 2006.

[35] Unit trust and OEIC sales have begun to recover following a three year slump between 2000 and 2003. A 10.4 per cent growth between 2003 and 2004 saw total sales exceed £30 billion for the first time since 2000.

[36] Source for all information within this paragraph: 'UK IFAs 2005', Datamonitor, January 2006.

[37] Ibid.

IFA firms increased by 1.6 per cent from £4.97 billion to £5.05 billion, while the total number of firms in the market fell from 11,614 to 11,516. As a result the average annual turnover of IFA firms increased from £430k to £440k.[38]

B.24 In general, IFAs can be segmented into five categories:[39]

- networks and their members
- nationals – IFAs with a turnover of £5 million or more, or with ten or more outlets
- big IFAs – a single outlet firm with annual turnover between £1 million and £5 million
- regional – an IFA with outlets in two or more regions, and
- single outlet – a single outlet firm with annual turnover less than £1 million.

B.25 The number and turnover of each of these types of firm in 2005 are shown in Table B.1.

Table B.1 - Number and turnover of IFA firmbs by type (2005)

Type of IFA	Number	Gross annual turnover (£m)	per cent of total IFA turnover	Average annual turnover per IFA firm (£m)
Network members	5,542	1,098.9	21.8%	0.20

[38] Ibid.

[39] Matrix IFA Database definitions. Matrix-data solutions is an organisation that provides data, analysis, and other information for the financial services and adviser industry.

Nationals	87	1,909.1	37.8%	21.94
Big IFAs	219	376.5	7.5%	1.72
Regional	389	317.6	6.3%	0.82
Single outlet	5,279	1,343.7	26.6%	0.25

Source: 'UK IFAs 2005', Datamonitor, January 2006 (Matrix-Data)

B.26 In the period 2003 to 2005, the sales of both single outlet and regional IFAs declined significantly (by 23.9 per cent and 25.7 per cent respectively). National firms enjoyed a large increase in turnover of 38.8 per cent while network members also saw a positive, although more modest, change in their sales.[40]

B.27 The structure of the IFA sector has changed between 2003 and 2005. The number of network members fell by 140 and the number of regional IFAs fell from 492 to 398 in the same period. Meanwhile, the number of single outlet firms increased by 2.6 per cent.[41] These changes in market structure may indicate a certain degree of market consolidation, with the number of firms falling and share of turnover shifting to the larger firms (see further below).

Understanding buyers

B.28 Consumers will buy financial products for a number of reasons, for example to provide for themselves following retirement or to

[40] Source for all information in this paragraph: 'UK IFAs 2005', Datamonitor, January 2006.

[41] Ibid.

provide financial support to their dependants after their death. A survey by research institute IFF Research Ltd of people who had recently purchased financial products gave the main reasons for seeking financial advice as:

- a lack of knowledge about financial services in general
- a lack of up-to-date knowledge, and
- the need for guidance in specialist areas such as tax and pensions.

B.29 Some consumers visit advisers to seek reassurance from an expert of their own decisions, whilst others (usually with more sophisticated financial knowledge) use advisers only for convenience. The survey also found that the wide range of products offered by IFAs was attractive to consumers who felt that independent advisers were therefore able to provide more rounded advice and more likely to find a product that comes close to satisfying their needs.

B.30 Twelve per cent of respondents to another survey conducted by NOP in 2001 had received financial advice from an IFA in the previous 12 months, and this proportion generally increased with income.[42] Of these, 76 per cent had actively sought advice with the remainder having been approached by the IFA. Of the total respondents who had received some form of advice, 73 per cent had only spoken to one adviser with 19 per cent and eight per cent talking to two and three advisers respectively.

B.31 The independence of their advice is a key reason for using IFAs: various pieces of quantitative and qualitative research found that one of the most important reasons for visiting an IFA is that the advice given was expected to be more independent than that provided by tied agents or banks and building societies.

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[42] Source: 'Polarisation: Consumer Research', FSA, January 2002.

Consumers were generally found to be able to distinguish independent advisers from tied advisers, but were sceptical about the possibility for truly independent advice, particularly in the presence of commission based adviser remuneration.

B.32 Finally, a 2001 survey by Opinion Research Corporation (ORC) on IFA fees and commission considered how much consumers would be prepared to pay in fees for financial advice. The results indicate that consumers with more sophisticated financial knowledge and with a working relationship with other professional services are more likely to be willing to pay more for the services of advisers. This is put down to an appreciation of the expertise of the adviser and the possibility to obtain new ideas and receive advice on specialist subjects. Less sophisticated users tend to value financial advice less, and their willingness to pay is related to past experience. Also, frequent users were found to have a higher valuation of financial advice than one-off users.

B.33 In sum, it would appear that consumers particularly value financial advice in terms of the informational advantages held by advisers, the independence of advice on offer and the convenience that independent advisers provide when compared with a buyer seeking to accumulate similar information independently. The range of products distributed through IFAs relative to other channels is also important to consumers who feel that more choice will give them a greater chance of finding the right option.

Understanding sellers

B.34 In 2004, Datamonitor estimated that there would be movement towards the market being segmented into three types of product provider post-depolarisation:[43,44]

- 'premier league' - large, financially stable providers offering a wide range of products and services and with a strong public image, who would be attractive to multi-ties

- 'second division' – providers not offering a particularly strong product range, with some weaknesses in the eyes of IFAs, who would struggle in a multi-tied environment, and

- product specialists – niche players who are experts in their field and may be attractive to multi-ties who want to offer the best of a particular product.

B.35 Datamonitor believe that since the introduction of depolarisation, this transformation has already begun, and there has been a noticeable increase in the strength of the premier league providers.[45]

B.36 When investigating product provider preferences over remuneration structures, CRA considered the critical success factors for product providers based on their research into the industry and interviews with providers. They conclude that product providers prefer adviser remuneration systems that:

- incentivise intermediaries to deliver products cost effectively for example, remuneration that varies based on the costs to the adviser from administration and the technology used

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43 Source: 'UK IFAs 2005', Datamonitor, January 2006.

44 Prudential, Norwich Union, and Standard Life are examples of larger players who are popular with multi-ties (although they are not specifically referred to as premier league). GE Life and Scottish Equitable are described as 'more specialist players'.

45 Source: 'UK IFAs 2005', Datamonitor, January 2006.

- do not impose unnecessary systems costs, that is monitoring and processing costs
- allow providers to make a reasonable return which requires the correct alignment of remuneration and product charges
- maintain flexibility in matching commission to individual products, based on complexity, size, costs etc. This would also help new products to be more easily distributed in the market if there is a need to overcome initial consumer inertia
- maintain the ability of the provider to design the remuneration structure such that new or improved products can be signalled to, and identified by, the market. For example, it may be necessary to design a remuneration structure that works to cover the costs of searching out new products
- encourage competition in the intermediary market to avoid excessive commission and allow providers to make a return. Providers also prefer larger numbers of advisers as there is more scope for distributing their products
- maintain the reputation of the long term saving industry by providing no encouragement to mis-sell and incentivising advisers to provide ongoing advice
- help to avoid conflict of interest between providers and consumers in order to prevent regulatory intervention
- bring clarity to consumers so as to address issues of reputation. Structures which lead to advice being seen by consumers as valuable are important

- reward advisers for more sales that are 'attractive' to providers for example, sales to persistent and high value customers

- encourage attractive sales

- allow providers to develop good relationships with customers which is seen as beneficial for the prospect of selling new products and is good for the long term prospects of the industry, and

- are not so complicated that they cause too much confusion resulting in the system not having the desired effects.[46]

Role of intermediary

B.37 FAs have both buyer and seller facing roles. For product providers, they distribute the financial products matching them to suitable buyers. With respect to buyers, the role of IFAs is to provide independent advice on financial products, helping the buyer to identify and select the most appropriate investment given their financial situation and requirements.

B.38 The main services offered by IFAs to buyers are:

- to advise on complex financial issues. The scope of the advice may range from explanations of solutions to general financial needs to advice based on specific customer circumstances and requirements. When advising on the purchase of a financial product an IFA must select the most suitable financial product(s) for the individual investor

- to administer the sale of any products. In some cases the adviser may provide an execution-only service,

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[46] Source: 'Study of Intermediary Remuneration', Charles River Associates, February 2005.

administering the sale of a product without offering any advice and

- to provide ongoing advice based on changes in the market and personal circumstance of the client.

B.39 The benefits to buyers arise mostly through access to the advisers' expertise on complex products and through saving time that would otherwise be spent researching products and administering any sales. According to the Association of British Insurers (ABI), levels of financial capability are very low in the UK and advice is important to help consumers specify exactly what their needs are and to identify solutions.[47] IFAs will meet with customers to discuss their situation and will then devote time to scanning the product market for the most appropriate solution.

B.40 For the sellers, the IFAs play an important role in terms of generating sales and distributing the products. IFAs will also provide a means of advertising and create awareness for both existing and new financial products. The role of IFAs with regard to sellers differs from that of tied and multi-tied advisers in that the latter work specifically to promote the products of certain providers.

B.41 Financial advisers undertake a number of activities, including:

- contacting customers who require advice
- describing the nature and priority of different financial needs

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[47] Source: 'Financial Advice: How Should We Pay For It?',BI February 2005.

- explaining tax and benefit entitlements
- analysing specific personal needs
- choosing the right saving scheme provider
- arranging a purchase, and
- regularly reviewing personal circumstances.[48]

Key market players today

B.42 The financial advisory sector in the UK is highly fragmented with a large number of small firms. Datamonitor report that approximately 79 per cent of IFAs (who account for the majority of sales in the sector) have less than five sales people, and 87 per cent of the market has turnover less than £500,000. Only one per cent of IFA firms in the UK have a turnover in excess of £5 million.

B.43 The top twenty IFA firms (including networks) by turnover, which account for just 27 per cent of total turnover, are listed in Table B.2.

Table B.2 - Top 20 IFA firms by turnover (including networks), 2005

IFA Firm	Turnover (£m)	per cent of total IFA turnover
Sesame	300.0	5.9%
Barclays Financial Planning	163.0	3.2%
Millfield Partnership	118.4	2.3%

[48] 'Financial Advice: How Should We Pay For It?', ABI, February 2005.

AWD Wealth Management	106.5	2.1%
Tenet Group	80.0	1.6%
HSBC Bank	80.0	1.6%
Berkeley Berry Birch	62.7	1.2%
Positive Solutions	60.5	1.2%
Personal Touch Financial Services	57.0	1.1%
Thinc Destini	45.0	0.9%
Hargreaves Lansdown Asset Mgmt.	40.3	0.8%
Origen	34.2	0.7%
Towry Law Financial Services Ltd	33.2	0.7%
Lighthouse Group	32.0	0.6%
The Burns-Anderson Independent Ntwk.	30.6	0.6%
Grant Thornton UK LLP	27.1	0.5%
Alexander Forbes Financial Services	25.0	0.5%
Skipton Financial Services	23.5	0.5%
Savills Private Finance	22.5	0.4%
SBJ Benefit Consultants	22.0	0.4%
Total	**1,363.4**	**27.0%**

Source: 'UK IFAs 2005', Datamonitor, January 2006 (Matrix Data).

B.44 Sesame is the largest firm in terms of revenue, accounting for approximately 5.9 per cent of total UK IFA turnover, giving it a turnover five times greater than its closest competitor,[49] Barclays Financial Planning. In terms of sales staff, Tenet Group with 5,690 sales staff is the largest, followed by Sesame with 5,000 staff. These two are significantly larger than other firms.

B.45 AWD Wealth Management has the highest turnover per sales person of the top twenty firms with an average of £750,000 per sales person in 2005. The next two highest are Hargreaves Lansdown Asset Management and Grant Thornton UK LLP with average turnover per sales person sales of £671,333 and £541,440 respectively. Sesame on the other hand generated only £60,000 per sales person in 2005.

Use of commission rates

Current charging structures and levels

B.46 Financial advisers are paid in one of three ways:

- through flat fees paid directly by the buyer to the adviser and directly related to the amount of work carried out by the adviser (for example, based on an hourly rate for time spent by the adviser working for the buyer). The fee is agreed before any advice is given and is payable whether the buyer purchases a product or not. The recent depolarisation legislation ensures that in order for an IFA to

[49] An important point to note here is that Bankhall, a specialist in the provision of support services for directly regulated IFAs, plays a similar role to a network and is close in size to Sesame. Some people/firms classify Bankhall as an IFA network even though the company itself does not. The firms' website states that 'we provide all the benefits associated with a traditional network, including full technical and software support, as well as sales and marketing support, but without the strings attached'. Since Bankhall is not classified as an IFA network it is not included in the Datamonitor analysis.

call itself 'independent' it must offer the buyer the option to pay by fee. As noted above, advisers can choose to work on a whole-market basis without offering the option to pay by fees but they are not allowed to call themselves independent advisers

- through commissions 'paid' to the adviser by the provider dependent on the sale of the providers' product. The adviser will negotiate a level of commission with the provider and these charges will be built into the product purchased (for example,. a percentage of the investment will be given to the adviser), and so it is still the buyer who ultimately bears the cost of IFA remuneration. A rebate may be offered by the adviser to the buyer, particularly in the case where an execution-only service is being provided. Under the depolarisation legislation, financial advisers must disclose the commissions they receive in a menu which compares the maximum commission received by the adviser with the market average commission levels for each product, or

- through a combination of fees and commission. An adviser may charge a flat fee to the buyer and also receive commission from the provider (the cost of which is of course again borne by the buyer). In this case the adviser will often offer the buyer a rebate whereby a proportion of the commission paid to the adviser will be returned to the buyer and usually put into the investment in order to reduce the total cost to the buyer relative to the investment.

B.47 Commission is the main way in which financial advice is paid for in the UK. Of savings products sold by IFAs, over 90 per cent of single-premium and 80 per cent of regular premium business, attract commission (only around 12 per cent of the total turnover of IFAs is coming from fees).[50] Many consumers still prefer to pay by commission as payment by fee is (mistakenly) seen as paying for a service that could otherwise be received for free, or because they want to avoid having to make a payment when not actually buying a product.

B.48 Commissions can take a number of different forms:

- initial commission – this is written as a percentage of the value of new business and is paid to the adviser in the initial period (which may vary across products and providers) and can be in the form of non-indemnity commission (paid as the premium is received, not subject to clawback) or indemnity commission (paid up-front but subject to clawback)

- renewal commission – payable after the initial period and based on each premium paid on regular premium contracts (for example, an adviser who sold a stakeholder pension may receive an annual payment of one per cent of all contributions to the pension). This rewards the intermediary for persistent business, and

- trail commission – an annual commission based on the value of the investment (for example, the adviser may take 0.5 per cent of the fund value each year). It plays a similar role to renewal commission for single premium policies.

B.49 Providers offer a wide variety of choices for structuring these commissions allowing for a trade-off between levels of initial commissions and renewal commissions. In fact, the ABI suggests that there are over 1,200 alternative commission structures used in the market.

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[50] 'Financial Advice: How Should We Pay For It', ABI, February 2005.

B.50 The following tables present the market average rates of commission, after rebates and expressed as net present values, for various product groups in the financial products market, as reported by the FSA in their 'Market average rates for menus' document. The figures are based on data collected for the period from 1 April to 30 June 2005.

Table B.3 - Market average rates for single premium products

Lump sum products	Market average NPV
Collective investments	3.59%
Investment bonds	5.25%
Annuities	1.32%
Income drawdown	5.09%
Personal and stakeholder pensions	4.77%

Source: 'Part A: Market average rates for menus', FSA website

Note: These are also the rates which must be used by firms to determine and re-express the market average in the typical commission 'shape' (or structure) in which they retain commission.

Table B.4 - Market average rates for regular (monthly) premium products

Monthly products	Market average NPV
Collective investments	26.49%
Endowments – 10 year term	43.63%
Whole of life assurance – Age 40	105.04%
Personal and stakeholder pensions – 10 year term	18.17%
Personal and stakeholder pensions – 25 year term	29.37%

Source: 'Part A: Market average rates for menus', FSA website

Note: These are also the rates which must be used by firms to determine and re-express the market average in the typical commission 'shape' (or structure) in which they retain commission

B.51 These figures show considerable variation of the average NPV of commission payments (including initial, renewal and trail commissions) as a percentage of the lump-sum investment and as percentage of a typical monthly payment respectively. These differences hide the potentially much larger variation in commission structures (that is, the particular combination of initial and renewal and trail commissions) across products and providers.

B.52 The use of commission rates by IFAs has drawn significant criticism where it has been argued that these can lead to some form of bias in the advice that is provided to investors. In particular, critics argue that commission payments create remuneration that:

- 'tends not to be linked to investment returns

- is complicated and poorly understood by customers
- adds cost and inefficiency to the system
- makes product providers pay more attention to their distributors than their customers
- can lead to high charges at the beginning of a savings plan's life, penalising consumers who later want to move their money around and
- may encourage mis-selling by rewarding sales levels rather than quality of advice and on-going customer care'.[51]

B.53 Given such criticism the FSA proposed changes to the system with a Defined Payment System for independent advice (in 2002). However, cost benefit studies showed that there were various problems with this proposal as many customers were unwilling to enter a fee-based market, and that advisers incentives to seek out new customers would be reduced. Evidence on this comes from various sources:

- 'IFA Promotion/B-different found that only 11 per cent of consumers were willing to pay fees (with 63 per cent preferring commission and 20 per cent preferring fees with commission offset); 'If we only knew our sell by date', Research for IFA Promotion undertaken by B-different. March 2002. The question was based on a fee of £400
- AMP found that customers thought £100 was a fair figure for the total price of advice; Depolarising Financial

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[51] 'Financial advice: How should we pay for it?, ABI, February 2005.

Services: Customer Choice or Customer Confusion? Research for AMP undertaken by Teamspirit

- Swiss Re found that less than 2.5 per cent of consumers were prepared to pay more than £75 and less than 1 per cent were prepared to pay more than £100; The Insurance Report 2001. Swiss Re

- Continental Research found that 70 per cent of consumers thought that any fee should be less than £70; Continental Research 2000. Consumer research commissioned by London Economics

- The FSA found that consumers were willing to pay an average of around £70 per hour or a total fee of around £130. CP121: Reforming Polarisation: Making the Market Work for Consumers. Financial Services Authority, 2002'.[52]

B.54 Over the past few years, the Association of British Insurers, the ABI, has played an active role in analysing the use of commission rates in the sector and the nature of any commission bias if it did exist, and in February 2005 published a report by CRA (see below) which can be downloaded from the ABI website.[53]

B.55 Despite these concerns, there are several factors that appear to provide a rationale for the use of commission rates in the financial advice market:

- as discussed above, consumers tend to prefer paying by commission, despite the fact that this may cost them more in the long run than if they were to pay a fixed fee at the beginning. This may be due to a preference for spreading

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[52] 'Financial advice: How should we pay for it? ABI, February 2005.

[53] www.abi.org.uk

payment over a longer period, or because it gives consumers the perception of receiving free advice

- furthermore, commission based remuneration reduces the risk to consumers of paying for a service that they may not use. Marginal consumers who are undecided as to whether they wish to purchase a product and who would be discouraged from obtaining advice if they had to pay a fee upfront would, if paying through commission, be able to receive advice and then decide whether they want to proceed before making a payment commitment. With this in mind, it is arguable that using commission rates increases the size of the buyer market faced by advisers as the system would encourage consumers averse to making an upfront payment to enter the market.

B.56 The second of these reasons is, however, not valid in relation to the structure of commissions (which are in any case set by the product providers). The risk of paying for advice without then purchasing a product could be mitigated through fee-based payments being made contingent on the purchase of a product. Although this would imply that advisers may sometimes provide advice without being paid, this is not different from, for example, estate agents incurring cost in marketing a property that is then not sold within the duration of the contract.

Historic charging structures and levels

B.57 The LAUTRO[54] maximum commission agreement was introduced on 1st July 1988 to help minimise the potential detrimental

[54] The Life Assurance and Unit Trust Regulatory Organisation is now part of the Personal Investment Authority, a directorate of the FSA.

effects of commission. It was abolished in December 1989 after the OFT concluded that the agreement limited information to consumers resulting in restricted and distorted competition.

However, a Charles River Associates report notes that the LAUTRO rates are still (in 2002) commonly used to describe the structure of commission.[55] The following tables show the LAUTRO maximum commission rates for different types of financial product:

[55] Source: CRA, 'Polarisation: research into the effect of commission based remuneration on advice', January 2002.

Table B.5 - Lautro terms for regular premium policies

Product	Terms
Endowments	Initial: 25% of new business value during initial period Renewal: 2.5% of premiums after initial period Maximum initial period: 38 months
Whole of life policies	Initial: 25% of new business value during initial period Renewal: 25% of premiums after initial period Maximum initial period: 48 months
Personal pensions	Initial: 25% of new business value during initial period Renewal: 2.5% of premiums after initial period
Term assurance	Initial: 35%of new business value during initial period Renewal: 2.5% of premiums after initial period Maximum initial period: 27 months
Permanent health insurance	Initial: 30% of new business value during initial period Renewal: 2.5% of premiums after initial period Maximum initial period: 48 months

Source: 'Polarisation: research into the effect of commission based remuneration on advice', CRA, January 2002.

Table B.6 - Lautro terms for single premium policies

Product	Terms
Insurance bonds	Initial: Bonds purchased during 1988, 4.8% of new business volume, bonds purchased during 1989, 4.2%
Pensions	Initial: new business, 4% of new business volume, transfers, 1%
Annuities	Initial: 2% of new business volume
Unit trusts	Initial: 3% of new business volume

Source: 'Polarisation: research into the effect of commission based remuneration on advice'; CRA, January 2002.

B.58 In their report for the FSA in July 2000 London Economics examine the changes in the reduction in yield (RIY)[56] to conclude that charges for advice on life and pension products fell between 1995 and 1999, as indicated in

[56] Reduction in yield is the difference between actual yield on the product and the yield that would have been enjoyed by the customer if there were no charges.

Table B.7.

Table B.7 – Average RIY for life and pension products

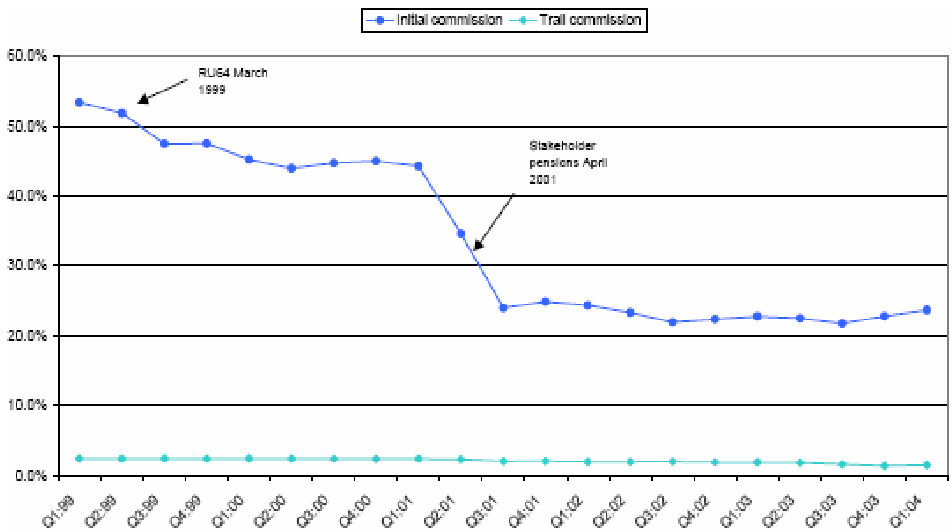
Type of policy	Average RIY	
	1995	1999
10 year with-profit endowment	3.4%	3.0%
Tax exempt 10 year savings plan	3.7%	3.0%
25 year mortgage type endowment	1.7%	1.3%
25 year personal pension	1.9%	1.6%
Single premium bond held for ten years	1.6%	1.3%

Source: 'Polarisation and Financial services Intermediary Regulation' London Economics report for the FSA, July 2000.

B.59 The report also suggests that the structure of commission changed in the period with more emphasis put on trail commission rather than initial commission.

B.60 More recent figures were published by CRA in their 'Study of intermediary remuneration' report for the Association of British Insurers in February 2005. The following figures illustrate the trend of average commission rates on a regular premium personal pension and a single premium personal pension.

Figure B.1 – Average commission terms on a regular premium personal pension



Source: CRA analysis based on the provider survey. 'Study of intermediary remuneration'; A CRA report for the ABI, February 2005.
Note: RU64 refers to Regulatory Update 64,[57] PIA

[57] Regulatory Update 64 (RU64) was issued by the Personal Investment Authority in 1999 to give firms selling personal pensions guidance on good practice in advance of the launch of Stakeholder Pensions (SHPs) in April 2001. RU64 fell away following the introductory launch of SHPs but the standards it established were brought into the FSA handbook in November 2001 as CPB Rule 5.3.16, FSA/PN/073/2005.

B.61 There has been a decline in initial commission rates since 1999 while trail commission rates remained fairly stable over the observed period. In early 2001 even before the Stakeholder Pensions (SHPs)[58] were launched, commission rates began falling sharply to half their previous level. Average commission rates continued to stay low following the introduction of SHPs.

B.62 The effect of stakeholder pension charges was felt on the market much earlier due to an update in the rules by the FSA, which anticipated the introduction of stakeholder pensions. RU64 set out that advisers needed to make sure that consumers were not 'materially disadvantaged' by being advised to take out a particular product in comparison to a stakeholder pension.[59]

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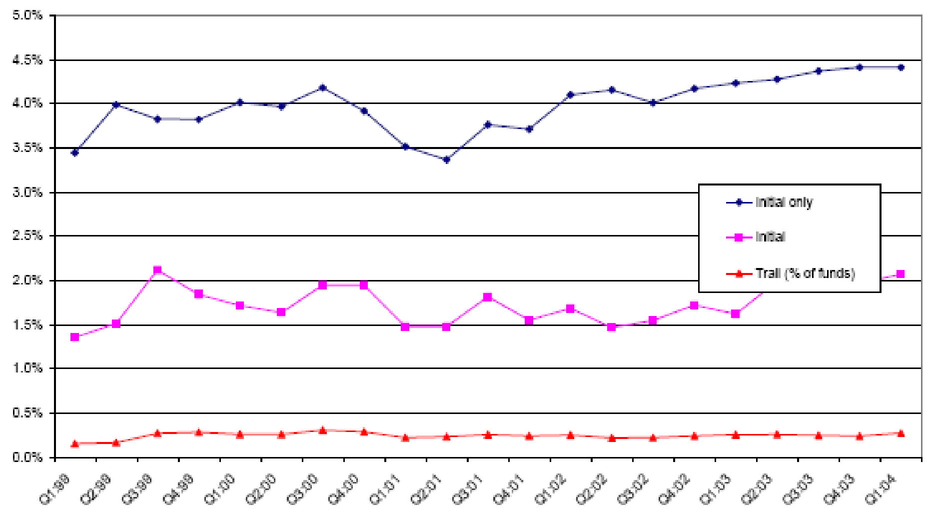
[58] The Stakeholder Pension was launched in April 2001 as a new form of private pension (It can be bought from a commercial financial services company, such as a bank, insurance company or building society), part of the government's overall pension policy to change the ratio of state to private provision of pension from 60:40 in 2001 to 40:60 by 2050. 'Stakeholders Pensions', House of Commons Library Research Paper, August 2001 (Tim Jarvis).

Early figures published by the Association of British Insurers (ABI) in August 2001 show that nearly 90,000 employers had designated a stakeholder pension scheme for their employees. They also show that 224,506 stakeholder pensions were sold in the first three months since they were launched in April 2001. This includes some conversions from pre-existing pension arrangements. RU64 set out that advisers needed to make sure that consumers were not 'materially disadvantaged' by being advised a particular product in comparison to a stakeholder pension. This led to a decline in charges.

[59] 'Study of intermediary remuneration', A CRA report for the ABI, February 2005.

Figure B.2 – Average commission terms on a regular premium personal pension



Source: CRA analysis based on the provider survey. 'Study of intermediary remuneration'; A CRA report for the ABI, February 2005.

B.63 Although in the case of single premium personal pensions, initial commission rates dipped at the start of 2001, they were not as badly affected by the introduction of SHPs as regular premiums. The average commission on a single premium fluctuated between 3.5 per cent and four per cent and has been on the rise since the second half of 2002. Similar to regular premiums, the trail commission rates of single premiums has remained fairly stable; suggesting that the overall impact of trail commission rates on fluctuation of commission rates in general is minimal.

Review of studies undertaken to date

B.64 As part of the financial advisory case study we have collated and reviewed various pieces of literature on charging structures in the sector. A brief summary of the various reports is set out below.

l) 'Polarisation and Financial Services Intermediary Regulation'; London Economics, June 2000.

B.65 After the Director General of Fair Trading (DGFT) concluded in his 1999 report that the polarisation regime was a cause of competitive issues in the market for collective investment products, London Economics were asked by the FSA to conduct research into the regime and analyse possible alternatives.

B.66 Four different policy scenarios and two other variants were compared to the (then) current regime. The four scenarios were as follows:

- redefinition of polarisation for all products – firms can choose to be tied, multi-tied, or independent and must provide disclosure of status and interest
- collective investment schemes removed from the polarisation regime, recommended by the DGFT
- minimum standards exemption – simplified packaged products (CAT ISAs, stakeholder pensions etc) removed from the ambit of polarisation, and
- retaining the essentials of polarisation while allowing tied advisers to introduce products of other providers to fill gaps in the market.

B.67 The two additional variants were:

- the separation of product panel selection from the negotiation of commission, and

- differentiating between advisers remunerated on a fee basis and those remunerated on a commission basis.

B.68 London Economics found that, in line with the findings of the DGFT, polarisation blunted competition in the tied distribution channel but also had a positive impact in terms of clarifying the status of advisers. Thus any changes made should be careful not to reduce the degree of transparency in who is independent and who is not and should be designed not to alter the size and independence of the IFA channel.

B.69 Using cost benefit analysis London Economics concluded that the best option was the first scenario in which polarisation is redefined to allow agents to become multi-tied. Despite resulting in direct costs to the FSA and compliance costs for regulated firms, these costs would be outweighed by significant competition benefits bringing in increased sales and lower prices. The IFA channel would not suffer due to the value placed by IFA customers on independent advice that would make it unprofitable for IFAs to switch to multi-ties. As such, this was said to be the most economically attractive option.

B.70 The DGFT recommendation was said to 'reduce the effectiveness of competition'[60] and increase the potential for consumer detriment by allowing advisers to use different statuses whilst advising on products that are close substitutes.

B.71 The minimum standards exemption option was found to be less detrimental than the DGFT recommendation but also offered few benefits, while the last scenario is little different to the existing regime, although some minor benefits might arise through enhanced competition between providers in the tied market.

B.72 The two variants also had little impact on the market. The separation of panel selection from commission negotiation would

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[60] Page 2, paragraph 3.

have few costs or benefits while the option to differentiate between fee and commission remunerated advisers may have some adverse effect on consumer detriment.

II) 'Polarisation: Consumer Research', FSA, January 2002.

B.73 In this report the FSA present the findings of six consumer studies commissioned by the FSA to help with its investigation into possible changes that could be made to the polarization regime.

B.74 The studies and their aims are shown in the table below:

Table B.8 – Consumer research

Research body	Aim of study
NOP Research	Investigate consumer use and perception of advice
IFF Research Ltd	Investigate consumer use and perception of advice
ORC International Ltd	Investigates attitudes to the status of advisers and perceptions of advice
ORC International Ltd	Explore consumer attitudes towards adviser remuneration
IFF Research Ltd	Investigates ability of consumers to understand a more complex disclosure regime

IFF Research Ltd	Investigates ability of consumer to understand a more complex disclosure regime

Source: 'Polarisation: Consumer Research'; FSA, January 2002.

B.75 The main conclusions to emerge from these studies were:

- the main reason for seeking financial advice is a lack of knowledge of the industry. Some use advisers for reassurance and others for convenience

- consumers clearly differentiate between advice and information and believe that advisers should have up to date knowledge, be trustworthy, and be able to give clear explanations. Advice should be honest, appropriate, and specific to the consumer

- more sophisticated consumers are able to distinguish between tied and independent advisers. Less sophisticated consumers show a lower ability to do so before visiting an adviser, although most consumers were clear about the distinction between dependent and independent advice

- independent advice is generally seen as better than tied advice, although consumers are sceptical about the possibility of truly independent advice and believe commissions are likely to create bias

- even when advice is paid for by fee, consumers are still cynical about the existence of unbiased advice

- tied advisers are chosen more on the basis of trust than adviser status, but status is important in choosing to use an independent adviser

- before getting advice, consumers are generally confused over how IFAs are paid, and most believe that the cost of commission is born by the product provider

- when they do understand that advisers are paid by commission, many consumers feel that this may lead to bias and say they would prefer to pay a fee for independent advice

- financially sophisticated consumers are willing to pay more for advice than less sophisticated consumers whose valuation tends to be related to past experience of advisers, and

- most consumers would pay financial advisers less than they would other professions, thinking that IFAs should receive an average hourly rate of £70, compared to £130 for doctors.

III) 'Polarisation: research into the effect of commission based remuneration on advice'; Charles River Associates, January 2002.

B.76 The Financial Services Authority (FSA) commissioned Charles River Associates (CRA) to investigate the extent to which the use of commission rates as a remuneration structure leads to bias in the market for financial advice, and whether this results in any consumer detriment.

B.77 To accomplish this, CRA carried out both statistical analysis relating new business to commission rates, and a mystery shopper exercise to compare the advice given by a number of advisers (179 observations were recorded) with the recommendation of a panel of experts.

B.78 Bias is considered in the report on two levels: product bias which may arise through advisers recommending product types that offer higher commission and provider bias that would result from advisers favouring a particular provider.

B.79 The statistical analysis was based on data provided by 25 product providers who pay commission to advisers. The analysis of product bias is of a descriptive nature and examines the effect of changes to commission rates offered on the amount of new business generated for the corresponding product. The evidence suggests that:

- there is no general tendency for new business to be positively related to changes in the commission rate, but
- there may be product bias in the cases of single-premium saving and investment products and personal pensions.

B.80 The econometric analysis concentrated more on the existence of provider bias. A panel approach is used to isolate the relationship between changes in commission and provider market share. The findings are:

- there is prima facie evidence of some provider bias in the single-premium packaged savings and investment product categories, and
- for regular premium products, the only product category for which the analysis indicates potential provider bias is the unit-linked endowment market.

B.81 Unlike the statistical analysis, the mystery shopper exercise concentrated more on testing for product bias than provider bias. Under one of four different scenarios[61] the mystery shoppers

[61] The four scenarios consisted of two in which the customer was receiving advice on making a lump sum investment (one with a budget of £15,000 and one with £30,000), and two with a self-employed person looking for a pension using five per cent or 10 per cent of income.

visited financial advisers and the recommendations received were compared to the option considered to be best by a panel of financial advisers assembled by the FSA. The results showed that:

- in most cases there is no reason to be concerned about biased advice due to the use of commission
- there is, however, evidence of possible bias in the medium term savings and investment market, and
- regulation in the pension market appears to have eliminated the scope for bias and consumer detriment. There is no need for concern regarding the recommendation of either Stakeholder or non-Stakeholder pensions.

B.82 CRA find that 'in a small but not insignificant number of cases there is detriment as a result of product bias in the medium term saving and investment market'.[62] The total detriment is estimated to amount to around £142 million per annum.

IV) 'Study of intermediary remuneration'; Charles River Associates, February 2005.

B.83 Following criticism by the Treasury Select Committee of the nature of remuneration in the saving and investment industry,[63]

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[62] Page 47, paragraph 1.

[63] In particular, the Treasury Select Committee argued that (i) commission leads to a conflict of interests between advisers and buyers, (ii) there is a need for greater comparability between fee based remuneration and commission rates, and (iii) trail commissions are inappropriate if the consumer is not receiving any ongoing advice.

Charles River Associates (CRA) was commissioned by the Association of British Insurers (ABI) to assess any consumer detriment resulting from the current remuneration system and to examine changes that could be made that would benefit consumers and increase confidence in the long-term insurance industry.

B.84 To do this, they compared how the current market trends measured up to the critical success factors of different stakeholders and whether this led to a remuneration system that met consumer needs.[64]

B.85 After assessing the effects of recent regulatory changes (depolarisation, the menu system, the introduction of stakeholder products etc) CRA conclude that the problems concerning bias are due more to perception than reality, but that public concern is justified and something should be done in order to regain consumer trust in the industry. Given the concerns, they analyse 23 alternative remuneration structures (including a fee based model) and recommend:

- an explicit and transparent charge for ongoing advice which may vary between products but should be standardised between providers
- that providers should determine if there are any products that require ongoing advice and how to encourage this
- that customers are informed annually of any ongoing payments to their advisers and the service they can receive in return

[64] The critical success factors determine the idea outcome from the point of view of each of the individual stakeholders considered. These stakeholders are consumers, intermediaries, product providers, and financial regulators.

- that payment for ongoing advice should be transferable from one adviser to another at the request of the consumer

- the introduction of a set of simplified remuneration structures agreed by the industry that would increase the effectiveness of the menu system by making charges more comparable across advisers and products

- that the remuneration system should allow flexibility on the level of initial commission, uplifts to particular advisers, and the offering of rebates to buyers

- variation between products but standardisation between providers on the period over which initial commission is paid

- that the freedom for advisers to choose their own mix of initial and ongoing payment, and the freedom of providers to offer indemnity terms should be abolished, and

- that consumers should retain the ability to spread the cost of initial advice over time.

B.86 Another interesting point to take from this CRA study is their conclusion that artificially moving to fee based regime would not lead to benefits, based on the argument that no evidence of biased advice due to commission is found, and as such consumers would not receive better advice if they were to pay by fee.

C PRIVATE CLIENT STOCKBROKERAGE

C.1 Insurance companies, pension funds and individuals make up the three largest equity investor groups in the UK. Overall, some 34 million shareholdings are owned by some 12 million shareholders.[65] While institutional investment far surpasses investment by individuals in terms of value, more than 10 million people in the UK currently invest directly in stocks and shares to secure their financial futures.[66]

C.2 Stockbrokers perform an important function in completing share transactions on behalf of their clients. In the execution of trades a broker may act for either a buyer or a seller of stock, linking the trade to the market rather than a particular counterparty. Thus, stockbrokers are not performing a matching function, but assist with the mechanics of share transactions, and often also provide advice.

Understanding the sector

C.3 In the UK there are several ways in which an individual can own shares. These can be in the form of a collective investment fund (for example, unit trust), in a corporate nominee, in a broker nominee, hidden in a 'tax wrapper' (for example, PEP or ISA), as a personal CREST (the UK's share settlement system) member or directly in the person's own name.

C.4 The number of shares traded on the London Stock Exchange (LSE) reached approximately 706.4 billion in 2002, with turnover of UK equities reaching £1,815 billion. Individual investors (also referred to as private clients or investors) held approximately 14.3 per cent of all equities traded on the LSE over the same period, with institutional investors holding the remainder.

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[65] Consultation, ICSA, 2006.

[66] Source: Association of Private Client Investment Managers and Stockbrokers (APCIMS) website.

C.5 This study focuses on the investment in shares by private clients only. That is, we have not included an assessment of the fees paid for investment services by institutional investors. There are a number of reasons for this:

- while private clients represent a small share of the market by value, they represent a large proportion in terms of level of activity (measured by the number of deals)

- large institutional investors are generally, but not always, served by the various investment banks or market makers. These investors will on the whole negotiate and design contracts based on the characteristics of their particular expected deals and on access to services other than straightforward brokerage. As such, collating information on generally confidential and complex contracts and disentangling the prices these investors will face for brokerage services is beyond the scope of this assessment, and

- institutions often have more stringent constraints placed upon them relative to private investors, which means that they are more likely to require more portfolio management services than private investors. For example, pension funds, are under obligation to be able to match their liabilities in every period with returns generated within or before that period. This makes the choice of broker much more heavily focussed on the broker's ability to manage a fund's stock portfolio to ensure it meets these obligations than on the cost of trading, and the cost of execution of trades is often small relative to the total cost of broker services.

C.6 Nonetheless, where information is available publicly and is helpful for understanding the market or for comparative purposes, we have included in the case study basic information on institutional investors in the aggregate.

Market size

C.7 While private client stockbroking represents a medium to a modest proportion of traded equity value, it is by no means insignificant. In 2005, private client stockbrokers conducted 9.8 million bargains,[67] worth an estimated £154 billion. Together, full-service and execution-only stockbrokers had revenues of £972 million over the same period.[68] The total number of staff employed in the stockbroking sector was 10,533 at the end of 2005.[69]

Understanding buyers and sellers

C.8 According to Datamonitor, the typical UK individual investor using execution-only services is aged between 35 and 64, is upper or middle class and lives in or around London. Stock portfolios are generally small: 43 per cent of investors have portfolios worth less than £5,000, and 70 per cent have portfolios with a value of less than £20,000. Only five per cent of portfolios are worth more than £100,000.[70]

C.9 Buyers and sellers have discretion as to the level of broker services they wish to purchase and their level of involvement in their portfolio management. Direct participation in the market by

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[67] A bargain is a term used on the London Stock Exchange to describe a share purchase or sale. The term does not imply that the transaction was a 'special price' in the normal sense of the word.

[68] Source: 'In-Depth Review of Stockbrokers', ComPeer, 2006.

[69] This number has fallen during the last three years from 11,420 reflecting a drop in the number of firms in the sector and improved productivity.

[70] Source: 'UK Stockbrokers Databook', Datamonitor, October 2003.

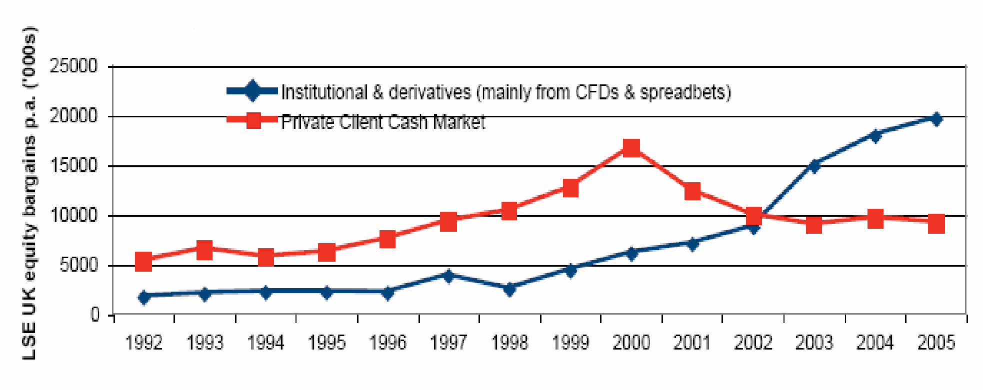
individual investors has been decreasing significantly over the past number of years; based on an analysis of the value of purchases compared to sales, ComPeer (2006) concludes that private clients have taken out approximately £14.6 billion of direct UK equity holdings since the beginning of 2003. The trend to sell over the last three years is very much prevalent amongst the execution-only or self directed investor.

C.10 ComPeer (2006) notes three potential causes for this withdrawal:

- first, clients may simply be liquidating assets in order to spend more money
- second, clients may be switching into collectives as a lower risk way of gaining UK equity exposure, and
- third, clients may be moving away from equities in favour of non-correlated asset classes such as property or simply remaining in cash.

C.11 Figure C.C.1 illustrates both the decline in private client trading volumes and the reduced share of total trading volumes across the LSE. Private client now accounts for 31 per cent of UK equity bargains and 21.5 per cent of all bargains.

Figure C.1 - UK equity bargains: institutional vs. private client



Source: 'Annual Report on Stockbrokers'; ComPeer, 2006.

C.12 Despite these developments, private clients continue to hold significant assets directly in securities; total assets held in nominee accounts across all wealth managers were valued at £198 billion at the end of 2005, and additionally there remains a very significant volume of certificated holdings which are maintained directly with company registrars.

Role of intermediary

C.13 The primary role of an intermediary in this sector is in the execution of deals, i.e. the agent is facilitating the transfer of shares between a buyer or seller and the market. At present, stockbrokers require licenses to buy and sell shares, thus making the use of an intermediary essential in any purchase or sale of shares.

C.14 In some cases stockbrokers only trade shares, while in others brokers have built up supplementary businesses in ancillary services predominantly driven by the advice that they can provide to the client on when, how and what to trade. Specifically, there are three main categories of stockbrokers:

- execution-only - the intermediary only conducts the trade on behalf of the client. This is generally the cheapest option and leaves the decision on which shares to buy or sell entirely with the client. This service is typically paid for on a flat fee basis, sometimes combined with a flat account fee

- advisory - in addition to executing trades on behalf of the client, the intermediary will offer the client advice on buying or selling particular shares. Employing the advisory expertise of a professional may remove some of the risk of choosing stocks but the final decision on which stocks to deal in is still the responsibility of the client. These services are typically paid for by commission on dealings, often in addition to a flat account fee, and

- discretionary dealing - the client gives the broker his/her investment objectives and all decisions regarding the trading of shares are then made by the broker. Investment portfolios typically reflect a relatively high risk-taking and high return-making goal. This tends to be the most expensive option, but is desirable for those wishing to delegate full responsibility for choosing stocks to a specialist third party. These services are typically paid for by commission on dealings, often in addition to a flat account fee.

C.15 Execution-only brokers' services revolve around the different means of completing trades: trades can be carried out over the phone or on-line. Some firms offer only one of these two options whilst others give customers the choice. There is also an option to trade certificated shares in this way.

C.16 All types of stockbrokers allow private clients to hold accounts with their firms. Broadly, shares can be held either as certificates or electronically through a broker's 'nominee' account. Nominee account holders will also often have to pay annual custody fees and do not have the same rights as certificated shareholders. However, there are advantages to holding shares electronically as brokers tend to charge less for trading electronically held shares, and settlement of trades takes longer for certificated shares. Full-service brokers usually provide both types of account.

C.17 1.72 million (41 per cent) of active execution-only shareholders had brokerage accounts in 2002, an increase from 1.48 million in 2000.[71] ComPeer (2006) reports that 4.2 million nominee accounts holding £121 billion of assets are now held with UK private client stockbrokers and wealth managers.

Figure C.2 - Brokerage account holdings

	Accounts	Estimated individuals	Active relationships
Online XO nominee trading	1,047	667	234
Offline XO nominee trading	1,286	429	130
XO certificated trading	1,022	511	26
Advisory	367	220	172
Discretionary	508	305	239
Total	4,230	2,132	800

Source: ComPeer Wealth Management Industry Report 2006

C.18 A significant proportion of shares are still held directly in certificated form however, and in 2005 there were 1.8 million certificated share trades, accounting for 17 per cent of private client direct securities trading. This proportion has remained at a similar level for the past three years, following sharp declines in previous years.

C.19 The level of nominee trading using execution-only brokers has increased in recent years. Certificated trades accounted for 42 per cent of all trades in 2000 and for only 20 per cent in 2005. It has however been stable at this level through 2004 and 2005.

[71] 'UK Stockbrokers Databook', Datamonitor, October 2003.

C.20 More generally, most investors use execution-only stockbrokers. These investors trade less often and conduct lower value trades than those using advisory/discretionary services:

- by volume, execution-only stockbrokers conduct 70 per cent of private client trades, with the other 30 per cent being made up of trades by advisory and discretionary brokers

- by value, 70 per cent of investment assets traded by stockbrokers are under an advisory and discretionary mandate, with the remaining 30 per cent being held under a non-managed (execution-only) mandate

- accounts with full-service brokers see nearly twice as many trades per annum than accounts with execution-only brokers (6.3 and 3.6 trades in 2005 respectively). The payment per trade for full-service brokers was over twice as high as for execution-only brokers in both 2004 and 2005.

C.21 In completing a trade, a broker is able to access the whole of the market at a price offered by the London Stock Exchange or a Retail Service Provider (RSP, discussed further below).

C.22 Shareholders place trade orders on two main bases: market orders, orders to buy or sell a stock at the current market price, and limit orders, orders to buy or sell a stock at a specific price or better.[72] Shareholders do not usually know what happens when they place an order to buy or sell shares. The stockbroker they use can place it with a number of different market makers (as

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[72] That is, if a buyer places a limit order, it will entail carrying out the order at the limit price or lower. Similarly, if a seller places a limit order, this is instruction to carry out the order at the limit price or higher.

usually more than one market maker is operating in the market for a stock). Even with SETs traded stocks, there are some alternative markets outside the London Stock Exchange that could be used, with possibly better prices.[73]

C.23 This makes assessing the effectiveness of a stockbroker in getting the best price for the client more difficult. The broker has superior knowledge relating to whether the price received for a market order is the 'best execution price', given that it is only the broker who knows the extent of the search they have carried out. In the case of limit orders, this information asymmetry is greater than with market orders, owing to the element of discretion lent to stockbrokers to get the best deal. That is, traders know the actual price of the deal after it has taken place but cannot necessarily assess whether this constitutes the best execution price given that the trader has only placed one binding constraint on the actions of the agent that is, setting a minimum for a sale or a maximum for a purchase to take place. One execution-only operator reported that around 20 per cent of its total trade orders are placed in this form, with the rest ordering immediate dealing for the 'best execution' price and that this is typical amongst similar operators in the sector.

C.24 According to the FSA, rules governing stockbroker behaviour come into play here; stockbrokers are required to inform their clients of the charges involved in trading. The focus of competition in this sector is on the price and service combinations offered to clients.[74] Alongside execution and advisory services, agents offer portfolio management services and stock tracking services. These save the client gathering information on their stock and on how the stock has been performing.

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[73] United Kingdom Shareholder Association (UKSA) website.

[74] More specifically, one stockbroker noted that the certificated share dealing market competes mainly on price then speed of settlement, followed by channel and quality of service, while the nominee share dealing market competes on price, quality of service and channel, given that settlement tends to be a market standard of T+3 days.

Regulatory framework

C.25 The UK market is governed by the transposition of the 1993 Investment Services Directive (ISD) and its more recent amendments in 2003, and is soon to be governed also by the Markets in Financial Instruments Directive (MiFID)[75] which extends the coverage of the ISD to most investment services. These Directives have been designed with a view to aligning national rules on the provision of investment services and the operation of international exchanges, allowing investment firms, with the authorisation of their home country, to operate across the EU, outside of the regulation of their national exchange.

C.26 A key element of the Directives is the idea of 'internalisation' which allows banks and other financial institutions to process client orders internally that is, to match suitable buyers and sellers from their own client base without having to interact on a stock exchange. This legislation requires these 'internalisers' to take on a public 'market-making' obligation – that is, disclose to the market the prices at which they would be willing to buy from or sell to their clients in liquid shares, though this requirement is restricted to orders below 'standard market size'. This is defined as the 'average size' for the orders executed in the market.[76] The European Parliament has put in place a set of measures to protect 'internalisers' from some of the undesirable risks that might be incurred through making such price quotes. These measures

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[75] The legislation is due to be published in the Official Journal of the European Union in October 2006 and firms will have to be compliant with the legislation by November 2007.

[76] This will ensure that European wholesale markets will not be subject to the rule and that wholesale brokers will not be subjected to significant risks in their role as market makers.

include the possibility to update and withdraw their quotes. The MiFID will also establish a fair marketplace for retail investors and prevent financial institutions from discriminating between small investors.

C.27 The Directives were introduced with a view to increasing competition in the market by allowing investment firms to compete across countries and also with the exchanges themselves. ComPeer (2006) reported that for brokers the MiFID potentially provides more opportunities on a European level, but also increased cost resulting from the need to set in place the necessary technology and regulatory processes to demonstrate best execution for clients.

C.28 On the London Stock Exchange trading takes place under two different systems:

- for higher volume stocks (typically FTSE-100 and other larger companies) the Stock Exchange Electronic Trading System (SETS) electronically matches buy and sell orders using an open order book (orders to buy and sell shares are displayed and matched on a computer screen)
- for smaller companies and lower volume or retail trades, the order book is not suitable for a number of reasons, principally because the order book provides for single block trades (trades of a standard block size)[77] and standard settlement only. In these cases, trading is generally performed by a system of Retail Service Providers (RSPs), who quote a bid/offer price at which they are prepared to deal.[78] These prices are the same as those offered on the

[77] The stock exchange facilitates wholesale trades by breaking all trades into standard blocks, say for example, blocks of 1000 shares, to enable sellers to sell a large block in whatever (large) quantities other wholesale traders wish to buy them. These traders are charged per block of shares that is dealt to fund this facility.

[78] United Kingdom Shareholder Association (UKSA) website.

official exchanges as they are generated using facilities provided by the London Stock Exchange, and RSPs can carry out orders in one single fill on the terms given by traders. RSPs rely on the RSP Gateway, a London Stock Exchange service which has been live since July 2002, providing a central facility for routing quote and execution messages between private client brokers and RSPs.[79] One market player noted that around 95 per cent of retail trades are carried out by RSPs.

C.29 This two-tier system does not, however, alter the role of the stockbroker as a pure intermediary which can conduct trades between one of its clients and either an RSP or the wholesale stock exchange.

C.30 The majority of trades are made through these RSPs which are often investment banks, such as Merrill Lynch, or other institutions such as Winterfloods, which is backed by Close Brothers Group plc, an independent banking group listed on the LSE. There are currently 18 registered market makers with a total of 6,435 security registrations compared to seven market makers with 4,681 registrations five years ago.

C.31 The LSE trading charges are set out per trade for different sizes of trade, including both a minimum and a maximum charge and charges per £1,000. Charges also differ for market makers who pay the LSE an annual service charge. Brokers, particularly for smaller trade sizes, have consequently been looking to RSPs to obtain lower charges.

[79] http://www.londonstockexchange.com/engb/products/membershiptrading /trading services/rspgateway.htm

C.32 In the UK in recent years, the sector has seen the rise of market making investment banks in the facilitation of small trades. These allow the use of an alternative trading platform to the official wholesale stock exchange and its related charges.

Key market players today

C.33 The sector is characterised by a relatively small number of large players, each with significant market share, though the level of concentration is still low. In the execution-only segment the five largest firms account for over 60 per cent of trading volumes and the three largest hold a combined share of 45 per cent. In the full-service brokerage segment the top five firms enjoy a market share of 63 per cent which has increased from 56 per cent in 2001.[80] The following table sets out the larger stockbrokers:

Table C.4 – Top UK stockbrokers

Barclays Stockbrokers Limited
Brewin Dolphin Securities Limited
Charles Stanley & Company Limited
E Trade Securities Limited
Halifax Share Dealing Limited
Hargreaves Lansdown Stockbrokers
Hoodless Brennan PLC
J M Finn & Co.
Redmayne-Bentley
Squaregain

[80] For the full-service stockbrokers, ComPeer examines shares in terms of revenue instead of trades given the different balance of business between advisory, discretionary and execution-only.

TD Waterhouse

The Share Centre Limited

Source: Based on the London Stock Exchange's list of the most active private client brokers on various stock exchanges, January – March 2006

C.34 Overall, the number of stockbrokers providing private client services has been steadily declining over time. The number of execution-only stockbrokers peaked at 44 in 2001 and now stands at 27. The high number of firms in 2001 was a result of new entrants providing on-line trading services. Several of these firms have now merged or ceased trading. Meanwhile, in the face of intense price competition, the traditional stockbrokers have migrated towards a full-service model based on advisory and discretionary business. With very low profit margins and subdued growth, continued consolidation in this sector is expected (ComPeer, 2006). There were 47 full-service stockbrokers at the end of 2005, down from 49 the previous year.

C.35 On-line brokers have increased their share of total trades over time. A shift towards electronic shareholding can in part be attributed to offering customers a CREST personal membership.[81] This allows shares to be traded electronically while the customer retains the full rights of a certificated shareholder. Of the 12 million shareholders in the UK, about nine million hold paper certificates but this only represents about 15 per cent of the total value of the share market (the remaining 85 per cent is already traded electronically using CREST).[82] Consequently, there are now 667,000 clients trading on–line, conducting 1.5 trades per

[81] CREST is the multi-currency electronic settlement system for UK and Irish securities.

[82] Consultation, ICSA, 2006.

quarter, and on-line trading accounts for 53 per cent of total trades.

C.36 Within the wider wealth management sector, which includes private client investment managers and private banks, the top five stockbrokers hold a share of 19.3 per cent which has remained broadly stable over the past four years.

C.37 Execution-only stockbrokers are increasingly competing head to head with spreadbet firms in the trading of CFDs.[83] Traditional firms and banks have largely maintained their position.

Use of commission rates

Current charging structures and levels

C.38 Stockbrokers revenues come from three sources:

- fees (periodic flat fees for holding an account)
- interest, and
- dealing commissions.

C.39 Brokers consider a number of factors when setting the level of these various charges. One broker reported considering income contribution analysis, comparison with competitors on price and service, internal standards and a risk and reward model, where the cost of the service at different levels reflects the varying degree of risk associated with different trade volumes. Overall, commissions represented 61.5 per cent of execution-only brokers' revenues but only 53.7 per cent of full-service broker revenues in 2005.

[83] CFDs or Contracts For Difference are a leveraged equity derivative security that allow users to speculate on share price movements, without the need for ownership of the underlying shares.

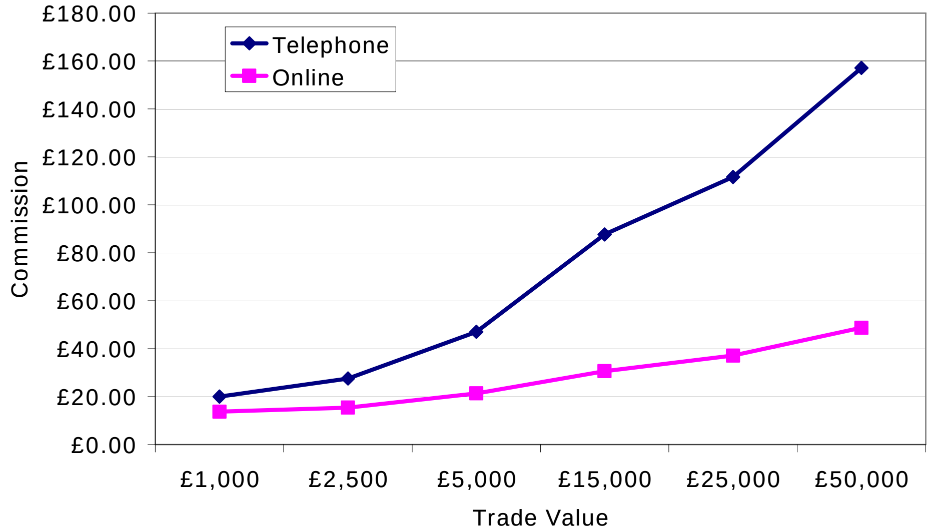
Execution-only stockbrokers

C.40 To execute a trade, execution-only stockbrokers charge flat fees, schedules of fees that depend on the value of the trade, or percentage commissions on the value of the trade. Of the brokers that offer more than one trading option (usually on-line and over the telephone), some use the same charging structure (flat fee or commission) for both trading methods whilst others charge a flat fee for one and a commission rate for the other (in this case the tendency is to charge a flat fee for on-line trading and commission rate for over the telephone trading). Even if the same charging structure is used for both on-line and over the telephone trading, brokers will often charge at different price levels for the two (e.g. a flat fee of £10 per on-line trade and £15 per telephone trade). Brokers may charge a single flat fee for on-line dealing that does not vary with the size of the trade, and a schedule of flat fees depending on the value of the transaction for telephone dealing.

C.41 In general terms, dealing over the phone is more expensive for investors than dealing on-line. According to Datamonitor (2004), on average, a £1000 trade over the telephone costs 34 per cent more than if it were carried out on-line; the average charge for on-line dealing is £13.70 for a £1000 trade as against an average cost of £19.99 for a trade of the same value over the phone. A £50,000 trade costs 71 per cent more (£48.71 for an on-line trade compared to a cost of £157.13 over the phone).[84]

Figure C.3 - Average commissions, April 2003

[84] Source: 'UK Stockbrokers Databook', Datamonitor, October 2003.



Source: own calculations based on data from the 'UK Stockbrokers Databook'; Datamonitor, October 2003.

C.42 When a percentage commission is charged, there is typically a schedule of commission rates, with the rate decreasing with the value of the trade, although the rates at which prices are decreased vary across firms. These commission rates may also be subject to a minimum and/or a maximum fee.

C.43 There is more variation across firms' charging structures with regard to the execution of trades involving certificated shares, given the additional risk associated with this type of share.[85] Some execution-only stockbrokers do not, for example, offer a flat fee for the trading of certificated shares. One operator noted that charging structures involving flat fees are less suitable relative to shallow ad valorem commission rates because dealing in certificated shares is risky relative to electronic share dealing (with greater risk being associated more with higher value transactions than with low value transactions). Indeed, another operator noted the suitability of percentage fees in this sector as they reflect the level of risk borne by the dealer, which increases with trade value, and can be subject to a minimum charge used to cover fixed transaction costs. This principle can be applied using different values across trading channels to reflect other cost differences related directly to specific trading channels.

C.44 Some stockbrokers charge additional fees, such as annual or quarterly fees, which are independent of the number and value of any trades made. These charges allow execution-only brokers to ensure that small bargain sizes remain profitable and also provide a way for some firms to support lower dealing fees. A large

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[85] This is so for a number of reasons:

- trades take longer and are therefore exposed to a greater level of risk in terms of their transaction value
- share registers/registrars are not regulated
- there is a significant level of fraud carried out among certificated shares
- these risks are compounded by legal precedent, if a broker sells stolen stock the broker has to reimburse the aggrieved party (c.f. Sandstone v Halifax).

number of firms also charge clients to transfer their holdings to another account.

C.45 The Institute of Chartered Secretaries and Administrators (ICSA) is currently consulting on the dematerialisation of shares and share transfers. The proposal is for an electronic system to replace paper share certificates and stock transfer forms throughout the United Kingdom to become mandatory across the securities industry. The outcome of this consultation, which closed on 30 June 2006, could have a significant impact on the charging structure offered by stockbrokers if it resulted in regulation to that effect.

Advisory and discretionary stockbrokers

C.46 Advisory and discretionary stockbrokers make greater use of percentage commissions than execution-only stockbrokers. Brokers often have a schedule of charges, and the level of these charges vary significantly across firms. Commission rates are primarily determined by:

- the level of advice that is being sought, where higher commissions are levied by brokers offering a greater level of advice, and
- the volume of the trade, with generally decreasing percentage rates for larger trades (for example, one per cent commission on trade value up to £20,000, 0.5 per cent commission on surplus trade value).

C.47 Similar to execution-only brokers, the level of charges imposed by full-service brokers can be subject to a minimum and/or maximum level. Almost all full-service brokers charge an account fee.

Comparing execution-only and full-service brokers

C.48 The average revenue per trade is over five times greater for full-service brokers than for execution-only brokers (£161.70 and

£28.80 respectively in 2005). Some of this difference is accounted for by the difference in average deal consideration. For a large part, higher revenues per trade in the case of full-service brokers are matched by higher costs per trade; full-service brokers' costs were on average £137.10 per trade in 2005 compared to £26.60 per trade in the case of execution-only brokers. However, cost-to-income ratios are still significantly lower for full-service brokers; costs represented 92.3 per cent of income for execution-only brokers as against 84.8 per cent of income in the case of full-service brokers in 2005. However, the direct unit cost of carrying out a retail trade is very small; a market player reported that the direct cost of carrying out a trade includes a cost to the broker of around £3-4 per trade and a CREST charge of a further £2 per trade.

C.49 In the case of execution-only brokers, costs have reduced year on year for the past five years and as a result costs are now half their level in 2000. Indications are that further improvements will be difficult to achieve (they are close to their competitive minimum). Pre-tax profit margins are less than 10 per cent.

C.50 In the case of full-service brokers, 2005 saw revenues increase and costs remain under control to generate profit margins of 15.2 per cent on average. Most cost increases have been related not to increased volumes of business but to corporate and compliance costs. People are the largest component of costs, accounting for 52 per cent of costs in the execution-only sector and 66 per cent in the case of full-service brokers.

Figure C.4 – Stockbrokerage costs

	2002		2005	
	Total Costs £000's	% of Revenue	Total Costs £000's	% Revenue
Execution Only Brokers				
Premises & Facilities	55,590	20.3%	28,780	11.6%
Staff Expenses	7,729	2.8%	5,426	2.2%
IT & Information Services	59,739	21.8%	35,132	14.2%
Operations	18,455	6.7%	18,551	7.5%
Compliance & Regulation	4,847	1.8%	1,932	0.8%
Professional Fees	6,758	2.5%	4,628	1.9%
Marketing	19,391	7.1%	13,163	5.3%
Errors & Losses	2,765	1.0%	1,035	0.4%
Full Service Brokers				
Premises & Facilities	77,329	14.2%	68,566	9.5%
Staff Expenses	15,650	2.9%	22,444	3.1%
IT & Information Services	73,792	13.5%	56,921	7.9%
Operations	18,698	3.4%	20,219	2.8%
Compliance & Regulation	7,272	1.3%	7,119	1.0%
Professional Fees	15,780	2.9%	17,357	2.4%
Marketing	8,652	1.6%	7,233	1.0%
Errors & Losses	3,919	0.7%	1,712	0.2%

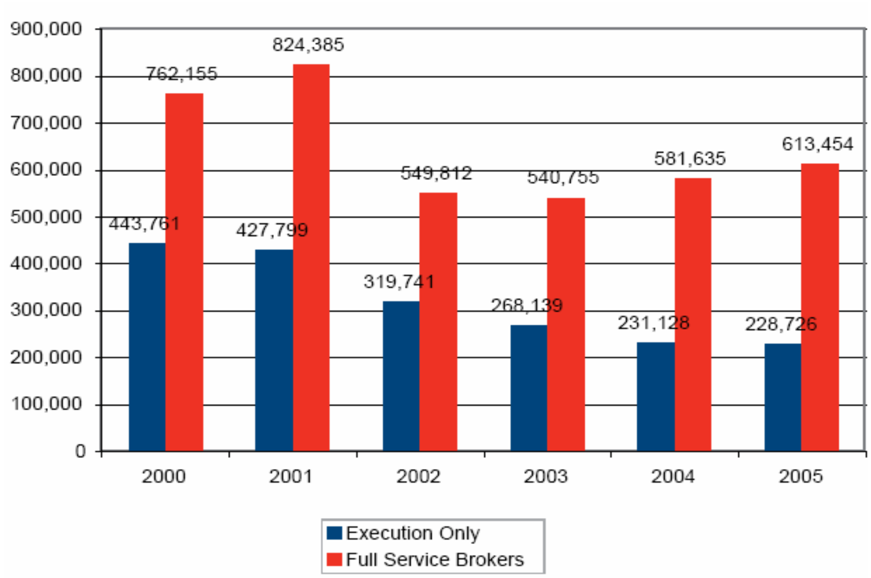
Source: 'Annual Report on Stockbrokers'; ComPeer, 2006.

C.51 Both types of brokers have seen a significant reduction in non-staff IT costs over the last three years. In the execution-only sector, this reflects an overall reduction in IT expenditure which, including all in-house staff costs, outsourced costs and non-staff IT related costs, reduced from £47 million in 2002 to £29 million in 2005. However for the full-service stockbrokers, there has been an overall increase in total IT expenditure from £25 million in 2002 to £35 million in 2005 as a result of an increase in IT staff costs.

C.52 Execution-only brokers are spending over five times as much as a percentage of revenue and almost twice as much in absolute terms on marketing than full-service brokers. This reflects the need for high levels of brand awareness and a strong presence on the internet and in key publications to build market share. Marketing costs have however still reduced overall with the pressure on profit margins. This contrasts strongly with the face to face, client referral approach of the discretionary and advisory stockbrokers.

C.53 ComPeer (2006) reports the total costs over time of execution-only and full-service brokers below:

Figure C.5 – Development of costs over time



Source: 'Annual Report on Stockbrokers'; ComPeer, 2006.

C.54 This illustrates that while the execution-only sector has continued to reduce costs over the last five years in response to increased price competition and as a result of re-engineering business through on-line client interfaces and straight through processing of execution and settlement, brokers focused on advisory and discretionary business have not been able on average to restructure their cost bases to the same extent. This has been due, for a large part, to an increase in fixed staff costs for full-service brokers from 33 per cent to 41 per cent of revenue between 2000 and 2005. ComPeer (2006) report that this shift is driven in part by the increased need to retain the top performing front office staff and also the larger proportion of higher paid support staff where traditionally lower levels of variable pay exist. This represents a risk to firms in the event of another downturn in markets, reducing ability to cut costs quickly.

Reporting of charges

C.55 Although there is no explicit requirement on brokers to disclose their charges to the FSA, most on-line brokers detail their fees extensively on their respective websites. ComPeer (2006) highlights that there is an opportunity to improve transparency of fees and, with greater transparency on investment performance, to demonstrate clearly to clients the value of advice. In addition, APCIMS' paper on unbundling and soft commissions notes that where research costs have been included in commissions, its firms are required to send written confirmation of transactions, and 'as well as setting out details of the transaction itself, explanatory text may highlight situations where commission has been shared with or received from third parties.'[86]

Historic charging structures and levels

C.56 The prices charged by stockbrokers were previously regulated. Following the 'Big Bang'[87] in 1986 – partly given increased

[86] Source: APCIMS website.

[87] Big Bang is a term used to describe the deregulation of the London Stock Exchange. Changes that were brought about by this include the following:

- ownership of member firms by an outside corporation was allowed
- all firms became broker/dealers able to operate in a dual capacity, where previously these roles were conducted separately – broking by stockbrokers, dealing by stockjobbers
- minimum scales of commission were abolished
- individual members ceased to have voting rights

competition in brokerage services – commissions became deregulated. As such, the previously set minimum commissions were abolished by the end of 1986. Many commission rates have fallen, on the whole becoming relatively low by international standards.[88]

C.57 Historically, shallow ad valorem commissions[89] represented a more widespread charging structure than is the case at present. The shift of a significant proportion of brokers to offering flat fees has been spurred on by developments in the market. The most prominent of these has been the development of transaction-only and on-line broking, both of which lend themselves to flat fees. In addition, the American model of broker remuneration shifted to include the flat fee structure. E Trade, an American firm, entered the UK market offering flat trading fees and quickly gained market share, acting as a broker for an increasing number of trades being carried out on-line. In the first quarter of 2006, E Trade was the fourth most active private client brokers on the London Stock Exchange. This has provoked a shift of remuneration structures among other on-line and execution-only brokers towards flat fees.

- trading moved from being conducted face-to-face on a market floor to being performed via computer and telephone from separate dealing rooms, and

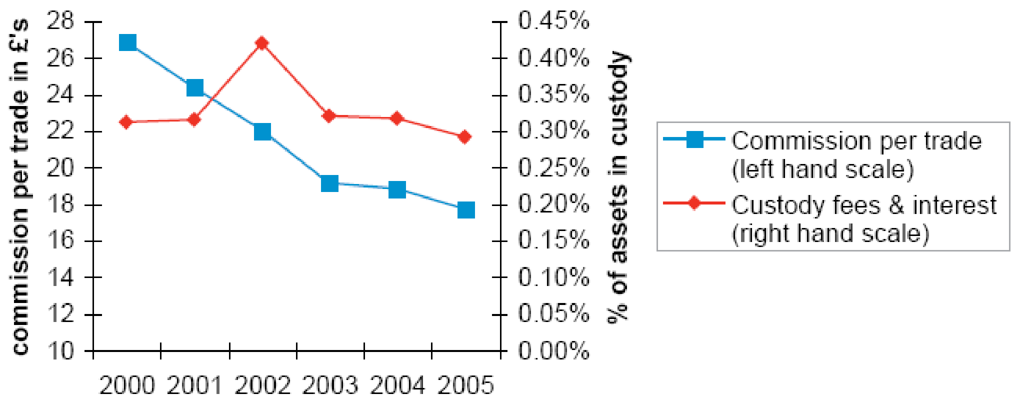
- the Exchange became a private limited company under the Companies Act 1985.

[88] Source: http://www.mof.go.jp/english/big-bang/ebb24.htm.

[89] An ad valorum charge is a charge the value of which is calculated according to the value of the transaction. A shallow ad valorum commission rate is where the rate charged on the value of the transaction decreases as the value of the transaction increases, therefore the absolute amount of commission paid on a transaction increases more slowly as the value of the transaction increases.

C.58 The cost of trading on an execution-only basis has fallen year on year since the arrival of on-line trading services. The average commission per trade has fallen from £26.83 in 2000 to only £17.70 in 2005.

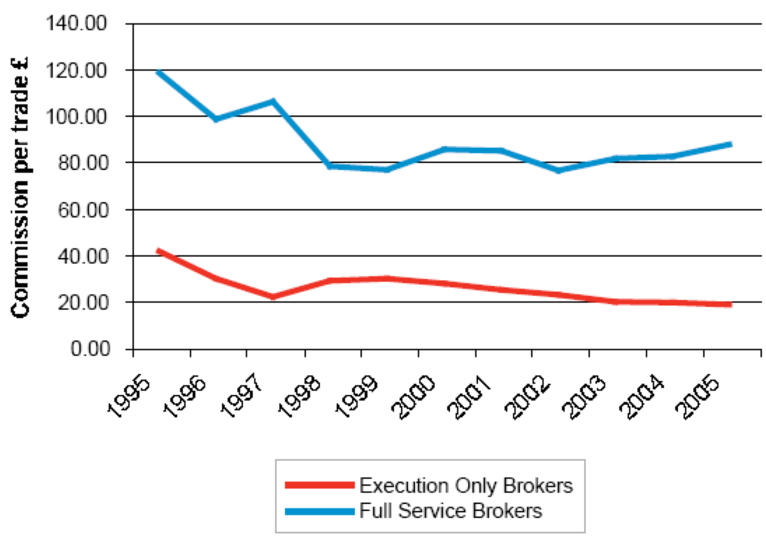
Figure C.6 – Cost to client of execution-only trading



Source: 'Annual Report on Stockbrokers'; ComPeer, 2006.

C.59 Amongst full-service brokers, percentage commissions have remained the prevailing charging model. Average commissions have increased over the last three years.

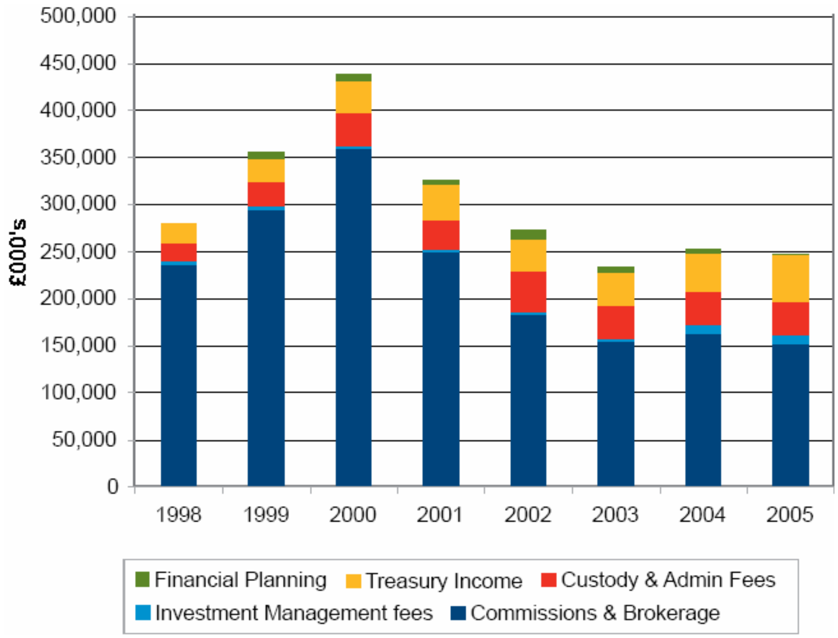
Figure C.7 - Average commission per trade



Source: 'Annual Report on Stockbrokers'; ComPeer, 2006.

C.60 The sector has sought to increase revenue from alternative sources in the face of the decline in trade commissions. Overall the percentage of revenue from commissions has fallen from 90 per cent in 1998 to 61.5 per cent in 2005 for execution-only brokers:

Figure C.8 - Revenue by type for execution-only brokers

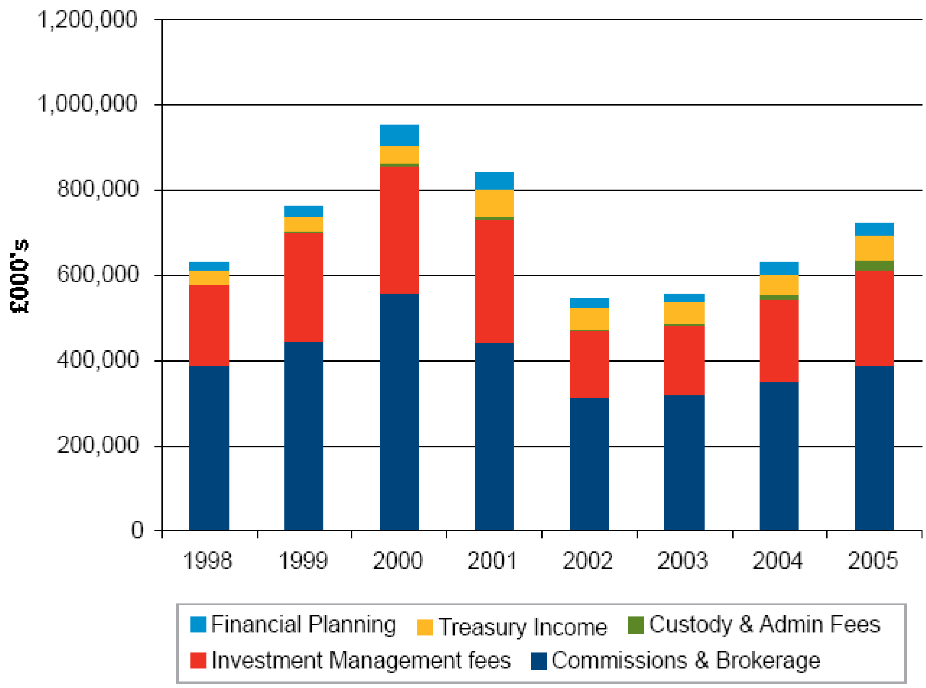


Source: 'Annual Report on Stockbrokers'; ComPeer, 2006.

C.61 The main driver behind the increase in revenues from other sources has been the growth in nominee accounts allowing for the introduction of custody and administration fees, and also for treasury income from net interest margin and foreign exchange spread on trading.

C.62 The full-service brokers have always had a significant proportion of revenue coming from management fees relating to advisory and discretionary mandates, and this has remained the custom over time. Management fees accounted for 31 per cent of total income in 2005, showing little change from 1998. These stockbrokers' charging structures continue to focus on a mixture of fees and commissions:

Figure C.9 - Revenue by type for full-service brokers



Source: 'Annual Report on Stockbrokers'; ComPeer, 2006.

D ON-LINE AUCTIONS

D.1 The on-line auction sector is relatively young, both in the UK and internationally. Unlike on-line retailers, on-line auction sites do not themselves sell goods or services, but rather provide a market place for others to meet and trade. By far the largest on-line auction provider, both in the UK and worldwide, is eBay, launched in the UK in October 1999, with trades (of both auction and non-auction items) in the UK in 2005 worth some £4 billion.[90]

Understanding the sector

Market size

D.2 On-line auctions have seen an explosion in use. eBay alone has over 200 million[91] registered users worldwide, 60 million of which were considered 'active', meaning they had either bid for or listed items within the previous year.[92] Approximately 89 million[93] items are listed on eBay websites globally at any one time, and sales worldwide for eBay were estimated in 2005 to be in excess of $40 billion.[94]

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[90] CBER press release, £3000 wealth windfall per family from 'eBay-onomics', 15 August 2005, http://www.cebr.com/archive1.html.

[91] eBay letter to DotEcon Ltd, 20 June 2006.

[92] 'Meg and the power of many', The Economist, 9 June 2005.

[93] eBay letter to DotEcon Ltd, 20 June 2006.

[94] Ibid.

D.3 The UK is a significant market for eBay with over 15 million[95] registered users and some £4 billion[96] in sales in 2005, of which on-line auctions accounted for an estimated £1.5 billion. With eBay accounting for around 90 per cent of all listings, this suggests that on-line auction sales in the UK are worth around £1.6 billion.

Understanding buyers

D.4 Unlike on-line stores, which users typically visit with the aim of purchasing a particular product, there is some evidence that buyers browse auction sites, not only for items they know they want, but also out of general interest. The typical visitor to eBay in 2003 spent one hour and eleven minutes on the site, much longer than the time spent visiting any on-line retailer. eBay described part of the appeal of on-line auctions as the 'serendipity factor'[97] because '[y]ou might go looking for a Madonna CD, but then you see an autographed poster which brings back all sorts of memories'.[98]

D.5 Some categories of listing are more popular than others (see Table D.5)[99] and buyers are clearly not dissuaded by the value of the item for sale: while relatively inexpensive items, such as clothes and DVDs, top the list there is a significant proportion of large ticket items for sale, for example, within the 'Cars, Part and Vehicles' category there are currently a few thousand cars up for auction.

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[95] Ibid.

[96] CBER press release, £3000 wealth windfall per family from 'eBay-onomics', 15 August 2005, http://www.cebr.com/archive1.html.

[97] 'Booting online', the Economist, January 2004.

[98] Ibid.

[99] A summary of the types of listings on alternative websites is set out at the end of this report.

Table D.5 - Listings on ebay

eBay current favourite categories	Number of listings
Antiques & Art	88,716
Baby	99,049
Computing	85,089
PC & Video Gaming	93,254
Photography	41,123
Consumer Electronics	66,934
Books, comics Magazines	268,153
Crafts	77,631
Sporting goods	133,866
Business, Office & Industrial	47,079
Dolls & bears	32,742
Cars, Parts & Vehicles	236,184
DVD Films & TV	229,457
Health & Beauty	83,870
Sports memorabilia	89,955
Clothes, Shoes Accessories	858,507

Source: www.ebay.co.uk as at 13 May 2006.

D.6 In a survey undertaken by Mintel in 2000, buyers gave a wide variety of reasons for visiting on-line auction sites and participating in on-line auctions. These are set out in Table D.2 below.

Table D.2 – Main attractions of on-line auctions

Main attractions/benefits of on-line auctions	All per cent	Bidders per cent	Visitors per cent
It's a way of getting a good deal	36	42	34
An easy way to find unusual /rare goods and services	29	39	26
It's a good way of finding items for my interests/hobbies/pastimes	27	33	25
An effective way of buying goods and services more cheaply than on the high street	20	25	18
Its cheaper than buying from other on-line retailers	15	16	15
They provide a convenient way of trading	14	25	11
The buzz of taking part in an auction is a form of entertainments	11	21	9
None of these	10	7	11
No opinion	3	-	4

Source: 'On-line auction sites'; Mintel Market Intelligence, October 2000.

Understanding sellers

D.7 Sellers on internet auction sites can include both individuals putting their own goods up for auction, or large and small companies seeking to reach a wider customer base. Indeed, sellers on eBay range from private individuals to some of the largest companies in the world such as IBM, HP and Vodafone.[100]

[100] eBay letter to DotEcon Ltd, 20 June 2006.

Retailers may use on-line auction sites in addition to a variety of other distribution channels such as other on-line market places, retail stores and their own websites.

D.8 The internet more generally has proven to be a successful means for companies to reach a wider range of customers; most large retailers now have an on-line branch to their business. However, for smaller retailers and individuals the barriers to setting up a website to sell a few products may prove prohibitive, in terms of:

- technical barriers – a retailer would need knowledge of how to set up a website for selling and processing payments

- cost/investment barriers – while internet shopping is typically characterised by low marginal costs, there are significant costs in setting up the service including designing and setting up the site, running it and updating it as necessary and facilitating secure payment, and

- attracting customers – in order to benefit from providing an on-line store, retailers need to attract new custom either in terms of existing customers buying more or capturing new customers (although customers may be wary of shops on the internet and reluctant to deal with unknown retailers). Small companies cannot typically reach the top of internet search engines which do not take account of price or quality of service, and The Economist has noted that 'achieving a high search ranking is crucial to success for many on-line businesses'.[101]

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[101] 'Dancing with Google's spiders', The Economist, May 2006.

D.9 On-line auctions, on the other hand, are an effective means for small and medium sized retailers and individuals to tap into the extensive internet market from which they might otherwise be excluded. In addition to standard auction formats, many on-line auction providers offer alternative formats, such as eBay's 'buy it now', which allow small retailers to create a virtual shop without needing to invest in the IT infrastructure and expertise that would otherwise be required. Indeed, such formats have become an important aspect of on-line auction businesses (for example, over 60 per cent of the items available on eBay's UK site are not up for auction).

D.10 For some sellers, targeting a local market offline may not be a viable option. For example, those selling specialty items or serving a limited population may not be able effectively to generate sufficient demand through traditional means such as retail stores or local advertising. On-line auctions provide a means for these retailers to target a much wider market easily and at low cost.

D.11 Competition between sellers, according to eBay, can be on a local, regional, national, or international level. 'Sellers may compete with offline 'bricks and mortar' businesses or 'bricks and clicks' retailers'.[102] Also highlighted by eBay is the role of price, quality of service, speed of delivery of results, trust and safety as critical success factors for sellers in such a competitive market.[103]

Role of the agent

D.12 The role of on-line auction websites is to provide a 'market' where sellers and buyers can effectively trade. eBay, for example claims to offer 'individuals and small businesses the chance to access a vast potential market for the goods they want to sell, in

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[102] eBay letter to DotEcon Ltd, 20 June 2006.

[103] eBay letter to DotEcon Ltd, 20 June 2006.

an easy and cost-effective manner'.[104] To accomplish this they offer two main facilities, namely:

- the space for sellers to advertise items, and the facilities for buyers to search what is on offer, and

- a set of rules governing how items are sold.

D.13 The agent provides a dedicated webpage for each item that is put up for sale where the seller advertises the corresponding item. Typically the page comprises details of the auction (for example, current price, number of bids and time remaining), a short description and several accompanying photographs of the item. Information is provided on the terms and conditions for shipping the item,[105] and the modes of payment accepted by the seller. There is often also a means of contacting the seller to ask questions about the item, delivery or payment.

D.14 Unlike auction houses where the auction for each individual lot is presided over by an auctioneer in person, on-line auctions rely on a set of rules embedded in software. These run the auction and they cannot be adapted by the seller, buyer or indeed the 'virtual' auctioneer. Each auction provider has its own set of auction rules which determine how and when bids can be placed, the nature of the end of the auction and how the final price is determined. The on-line auction provider does not typically facilitate payment as an

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[104] eBay letter to DotEcon Ltd, 20 June 2006.

[105] Note that, in principle, shipping costs could be used by the seller in order to reduce the amount it has to pay to the auction site. A seller could quote inflated shipping costs, which do not attract a commission, which would tend to result in lower bids (assuming that the buyer is ultimately interested in the total cost of the delivered item). We understand that eBay has a formal policy in place of monitoring, and relying on customers reporting, instances where shipping costs are being set at a level to bypass commission charges.

auction house would; rather they allow buyers and sellers to arrange payment terms between themselves.

D.15 On-line auction providers do not expend more effort in selling higher value items and do not provide any matching or advisory services, nor do they provide a guarantee of payment or of receiving goods. However, if costs had to be recovered through flat fees it is likely that it would no longer be attractive to sell lower priced items using on-line auctions and a large number of sellers would not find it profitable to participate. It seems clear that both sells and buyers benefit from positive network effects from there being more items for sale on a particular auction website.

D.16 If more buyers visit the site, sellers have a higher probability of making a sale at a favourable price. Similarly buyers have a greater chance of finding a suitable product/seller the higher the number of sellers operating on the site. eBay itself claims that allowing customers the ability to instantly access and browse through such a market brings about increased price competition and transparency.[106] These effects are larger the greater the number of sellers in the market.

D.17 On-line auction providers also typically provide ancillary services, which although not necessary for running an on-line auction, assist in reducing fraud, increasing consumer confidence and facilitating payment. For instance, eBay provides for an 'eBay community' where buyers and sellers can leave feedback about one another after a transaction. Other users can access this information to assess the trustworthiness of bidders and sellers. Such information is valuable to both buyers and sellers, with research indicating that higher rated sellers achieve a mark-up of

[106] eBay letter to DotEcon Ltd, 20 June 2006.

4.8 per cent on their individual lots when compared to low-rated ones.[107]

D.18 According to eBay, it is 'a key enabler and driver of UK e-commerce, providing a means for thousands of UK small businesses to get online and trade within the UK and globally on the basis of a 'level playing field'.[108] A survey conducted by AC Nielsen International Research revealed that over 68,000 people in the UK and over 170,000 people in the EU use eBay to generate at least one quarter of their income.[109]

Key market players

D.19 Today eBay is the largest UK on-line market place, having grown rapidly over a short period of time. The UK site is owned and operated by Switzerland based eBay International AG, and the eBay group of companies operates 33 websites worldwide, employing 12,500 people. QXL was the first on-line auction provider in the UK and market leader for a while; back in 2000 QXL was almost three times the size of eBay UK (in terms of number of items for auction). However, compared with eBay now, QXL has less than one per cent of all items for auction, and less than half a percent of the items for non-auction sale. It is not clear why QXL lost significant market share, however, a number of factors may be relevant including the share of eBay in the US

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107 'Doing eBay's bidding', The Economist, November 2001.

108 eBay letter to DotEcon Ltd, 20 June 2006.

109 eBay letter to DotEcon Ltd, 20 June 2006, and press, http://www.pressetext.at/pte.mc?pte=060207030.

and other European countries relative to QXL and eBay's affiliation with PayPal.

D.20 There has been significant change in the sector, with many prominent providers falling by the wayside as eBay has taken a greater share of on-line listings. Providers which in 2000 held thousands of items have ceased to exist (www.aucland.co.uk, www.goricardo.co.uk, www.fsauctions.co.uk). More recently, www.buyit.co.uk has put its business up for sale, and www.auctionzone.co.uk has no items for sale. Moreover, Yahoo, a well-established internet company, has chosen to close its UK and Irish auction site from June 2006, suggesting that this development is not simply about small fringe providers being unable to obtain sufficient investment to compete.

D.21 eBay reports that its UK site accounts for over 3 million of the 89 million listings on eBay websites worldwide.[110] Taking this as a base figure suggests that eBay accounts for at least 88 per cent of UK on-line auction items (see Table 3). Alternative providers have attempted to boost their share through offering free listings and charging only for extras such as premium listings.

[110] eBay letter to DotEcon Ltd, 20 June 2006.

Table D.3 - Market share of on-line auction providers

Provider	Number of items	Implied market share
eBay	3,000,000	88.4%
ebid	176,309	5.2%
CQOut	142,179	4.2%
QXL	33,507	1.0%
Hunt for it	30,669	0.9%
Avabid	12,797	0.4%
Buyit	158	0.0%

Source: Auction websites as at 13 May 2006 (excluding eBay, which is sourced from eBay letter to DotEcon.)

Range of products and services provided

D.22 While most on-line auction sites focus on domestic auctions, eBay in particular has branched out into three areas which have proved successful:

- 'buy it now' services, which allow sellers to set prices for their products
- virtual shops, that is, creating an on-line store for retailers who would not otherwise be able to do so, and
- international services, which enable buyers to search auction website from countries other than their own, and thus providing sellers with the opportunity to offer their products even more widely.

D.23 The importance of fixed price items (that is, items that are put up for sale rather than for auction) has increased: all four of the largest providers in the UK offer an option to sell items at a fixed price, and eBay recently has introduced a service which allows potential buyers to negotiate the price.

D.24 Although on-line auctioneers do not themselves take the responsibility for taking payment from buyers and passing it on to the seller it would seem that both buyers and sellers are demanding convenient and secure forms of payment. This is especially true for cross border transactions where banking fees may make trades prohibitively expensive (given that credit and debit cards are not an option for individuals selling one-off items). On-line auction providers have in the past offered payment services. PayPal is now the largest of these schemes, and as well as having an affiliation with eBay,[111] it can be used for payments between parties not conducting a trade on eBay including for trades on other auction websites. Indeed, PayPal has become an important payment mechanism in its own right with 72 million account holders world wide in 2005 – more account holders than American Express.[112]

Use of commission rates

Current charging structures and levels

D.25 The four largest providers charge a fee based on the final value for which a lot is sold, with different tiers applying to different value ranges. In addition, eBay and QXL charge a listing fee for posting an item for sale on the site. Table provides an overview of some current fees.

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[111] eBay purchased PayPal in 1999, though the two have remained separate companies, and eBay has not sort to restrict PayPal payments to only those transactions relating to eBay trades.

[112] 'Meg and the power of many', The Economist, 9 June 2005.

D.26 Small fringe providers often provide free listings, presumably in order to attract a large customer base, though with limited success. As this does not seem to have been a successful strategy, it would seem that consumers value more highly attributes of providers other than price.

Table D.4 - On-line auctions charges in 2006

	Listing fee	Final value fee
eBay	15p-£2	5.25 per cent of value below£30 3.25 per cent of value £30-£600 1.75 per cent of value over £600
Ebid	None	2 per cent of value or take out a membership costing from 99p (7 days) to £44.99 (lifetime) and pay no fees for the duration of the membership
CQOut	None, but there is a one off validation/joining fee of £2 for both buyers and sellers	5.29% of value up to £50 4.7% of value between £50 & £200 3.53% of value £200-£1000 and 1.76% of value in excess of £1000
QXL	5p-40p	3.75% on value below £15 2% on value up to £600 1.25% on value above £600

Source: individual websites, as at 13 May 2006.

Note: Different fees may apply for certain products, for example, motor vehicles

Historic charging structures and levels

D.27 eBay and QXL previously used different levels for their fees, but the overall structures have remained the same.

D.28

D.29 Table D.5 below sets out the average commission rates that were in use in 2000.

Table D.5 - On-line auctions charges in 2000

	Listing fee	Final value fee
eBay	15p-£1.25	5% of value below £15
		2.5% of value £15-£600
		1.25% of value over £600
QXL	15p-£1.25	5% on value below £15
		2.5% on value up to £600
		1.25% on value above £600
FSauctions	None	1p on value up to 25p
		4% of value £0.26-£500
		1% of value over £500
Aucland	No fees	
Goricardo		
Yahoo		

Source: 'On-line auction sites'; Mintel Market Intelligence, October 2000.

E TEMPORARY AND CONTRACT EMPLOYMENT AGENCY

E.1 There are more than one million temporary or contract workers in the UK at present. The sector has grown steadily since the mid-1990s, due mainly to the rise in temporary working and short term contracts and in 2005 there were approximately 12,700 recruitment offices in the UK, with 28,875 consultants recruiting solely for temporary or contract positions.[113]

Understanding the sector

E.2 Employment agencies are defined as 'firms that are in the business of providing services for the purpose of finding workers employment with employers, or of supplying employers with workers for employment'.[114] This case study looks at recruitment companies and employment agencies within the UK market that recruit for temporary and contract positions. It excludes firms that are seeking to fill permanent positions.

Market size

E.3 Key Note (2006) estimates that the value of the temporary and contract recruitment agency services worldwide was $187 billion in 2005. The US and the UK recruitment markets are the two largest in the world. UK labour markets are more flexible than those in Europe, with more than 50 per cent of temporary and contract appointments made in the EU occurring in the UK. In the year to March 2005, the value of the recruitment sector in the UK

[113] Source: 'Recruitment Agencies: Temporary and Contract', Keynote Market Report, 2006.

[114] Source: 'Recruitment Agencies: Temporary and Contract', Keynote Market Report, 2006.

was estimated at £23.48 billion, with £20.27 billion (86.3 per cent) of this being accounted for by the temporary and contract staff market (according to the Recruitment & Employment Confederation (REC))[115]. A report by the Chartered Institute of Personnel and Development (CIPD) noted that eight out of 10 UK employers use recruitment agencies to find employees, making it the second most popular method of recruitment, behind advertising in the local newspaper which is used by 85 per cent of employers.[116]

E.4 The market can be segmented into the following recruitment sectors: blue collar, computing/IT, drivers, education, financial, hotel/catering, nursing/medical, professional/managerial, secretarial/clerical and technical/engineering. Blue collar workers represent approximately a quarter of the market, followed by secretarial/clerical staff accounting for a further 20 per cent, and engineering appointments accounting for around 15 per cent. Demand in 2005 was strong for finance and accountancy, hotel/catering, computing/IT and driving.

E.5 Recruitment volumes are influenced by the level of economic activity. If the economy appears to be weak, or if the outlook for the economy appears uncertain, then the recruitment sector will be strongly affected. Similar effects arise from developments in particular industry sectors.

E.6 Temporary and contract recruitment agencies have recently been experiencing contraction: in the year to March 2005, the market declined in value and in terms of appointments made. One explanation for this is that changes in employment law and also a

[115] Source: 'Recruitment Agencies: Temporary and Contract', Keynote Market Report, 2006.

[116] Source: 'Recruitment Agencies: Temporary and Contract', Keynote Market Report, 2006.

number of the court cases in 2004-2005[117] have narrowed the difference between the rights of permanent and temporary and contract workers, making the recruitment of temporary and contract workers less attractive than it used to be.

E.7 Overall, recruitment agencies have large variances in performance, both during busy and quiet periods. In 2003-2004, the median recruitment company had a turnover of £545,000, ranging from £2.9 million among the top 25 per cent of companies to £64,000 among the bottom 25 per cent. Median profitability was 1.9 per cent, while the bottom 25 per cent of companies showed a median loss of 2.3 per cent. However, the top 25 per cent had a median profit margin of 8.3 per cent.[118]

E.8 2005 was a stable year for most recruitment agents; while the economy has improved, many fee earners have not billed more revenue. Company growth relates almost exclusively to an increase in headcount and a greater appetite from clients. Higher revenues have been generated by increased sales and not higher commission on sales.

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[117] In the first half of 2005, an Employment Appeal Tribunal (EAT) upheld a judgement made in 2004, in the case of Dacas v Brook Street, that the end user i.e. the agency's client, should be regarded as the employer, not the agency. In a case in 2005, Cable & Wireless v Muscat, an EAT ruled that the agency's client was deemed to be the employer of the worker, even though the contract between the agency and the worker suggested otherwise. In another case in 2005, Astbury v Gist, the Court of Appeal concluded that even though there had been no written contract between the agency and its client, the client was nevertheless the employer of the worker. Source: 'Recruitment Agencies: Temporary and Contract', Keynote Market Report, 2006.

[118] Source: 'Recruitment Agencies: Temporary and Contract', Keynote Market Report, 2006.

Understanding buyers

E.9 A company may wish to hire temporary or contract workers for a variety of reasons, but mainly related to retaining a flexible workforce. Hiring workers through agencies enables firms to obtain workers at short notice and for unspecified (and potentially short) periods of time. Typical reasons for relying on the services of agencies include the need to:

- fill a temporary shortage in a particular skills area
- cover for a member of staff who is on maternity leave or long-term sick leave
- fill a position at short notice
- plug several gaps in an organisation, or
- relieve a shortage of available permanent workers.

E.10 Employment agencies may be used because of the speed with which they can fill a vacancy, their ability to look for workers with scarce skills who may otherwise be difficult to find, or because an employer might not have an in-house recruitment manager or the agency is used as an outsourced supplier. Key Note (2006) notes that in the case of the employment of contract and temporary employees, employers' procurement departments are taking an increasing role in hiring and managing these staff. This may reflect the dynamic nature of some businesses and the fact that employers' specific future staff needs are consequently highly uncertain.

E.11 If a company is looking for workers to start immediately in order to relieve a temporary shortage, it may be willing to pay a premium, given that the alternative to avoiding staff shortages would be either to employ more workers than are generally required in order to maintain spare capacity, or to build an in-house recruitment team capable of finding employees at short notice.

Understanding sellers

E.12 There are several reasons why workers may look for temporary or contract employment through employment agencies. Typically these include:

- the flexibility offered by temporary employment, including the option to 'test out' various firms with which permanent employment might be sought in the future
- the requirement of employment only for a short period (for example, because they are between full time jobs)
- difficulties in finding a permanent position and the consequent willingness to work on a contract/temporary basis in order to maintain a certain level of income, or
- the willingness to sacrifice the certainty of long term employment for greater short-term remuneration, although wages and salaries for temporary and contract workers may be lower than for permanent employment.

E.13 It has been noted that the 45-54 age group is an important market for employment agencies and is set to grow more than other age groups between 2004 and 2009.[119]

Role of intermediary

[119] Source: 'Employment Agencies', Mintel Market Intelligence, October 2004.

E.14 Recruitment agencies find employees to fill vacant positions, matching the needs of an employer and an employee. There are two ways in which this is typically done:

- the recruitment agency screens potential candidates for a specific position and then passes their details on to the employer, who interviews a number of candidates and eventually employs a suitable candidate directly, or

- the recruitment agency directly employs people and then hires them to an employer wishing to fill a position.

E.15 The former is generally used more often for permanent positions or long term contract employment of technical staff (such as engineers and software developers). The agency typically receives a one-off payment, set with reference to the equivalent annual salary for the position. The latter is more commonly used for short term contract and temporary employment, and for employing unskilled workers (such as warehouse operatives). The recruitment agency contracts with the employee directly, taking responsibility for paying the employee and dealing with national insurance contributions and tax deductions. The fee earned by the agent in the latter case is the difference between the hourly rate charged to the company, and the rate paid to the employee plus any additional costs to the agent. Thus, the latter is not an agency arrangement by our definition in that the agent is itself part of the main transaction, and effectively re-sells labour to companies seeking to fill a particular vacancy.

E.16 In this way, temporary employment agents assume a higher level of risk. The associated cost depends on the likelihood that a particular employee may be placed with fee-paying clients, and the frequency and timeliness with which payments are received. Key Note (2006) found that the amount of time within which clients settle their accounts can vary and recruitment companies often experience cash flow problems. The risk associated with delayed payment of fees is sometimes avoided by the use of factoring companies which, at a cost, will advance around 80 per cent of a clients invoice value and may also take on responsibility for chasing late payments.

E.17 Contract employment agents fall between recruiters for full-time or long term positions and temporary employment agencies. Contract assignments are usually longer than temporary ones; contract workers are taken on for an initial fixed period of usually six months or a year. With contract employment, agents may fulfil a pure agency role in introducing parties to one another and avoiding the employment of workers on behalf of employers in some instances, but may also themselves employ contract workers. In the latter case, the practicalities of the agency role are the same as with temporary employment; the agent pays the salary on an hourly rate and bills this amount, with added commission, to the employer. In the former case, the agent remains outside the transaction, the salary of the employee is paid by the employer and fees are negotiated between the employer and the agent as a percentage of the salary to be paid to the employee over the length of the contract.

E.18 The way in which the contract is treated is typically dependent on the length of the contract; short-term contracts are more usually treated as temporary employment and longer-term or more skilled positions are more likely to be placed under contract employment. Ultimately the employer makes the decision on how positions are to be filled, though this decision is clearly dependent on the relative cost of the different options.

E.19 Recruitment agencies typically offer services to employers linked to specific steps in the recruitment process. Adecco, for example, link their services to the following steps in the recruitment process:

Table E.1. – Services offered to employers

Step in recruitment process	Products and services offered
Request/order	Provide multiple channels for order placement, centralised ordering for national clients, agree standards for candidates and facilitate e-ordering.
Remuneration advice	Often agencies are perceived as having a better understanding of the market and may thus provide advice on the level of remuneration that would be applicable to the position.
Candidate attraction	This can involve utilising an agent's branch network, internet job boards, print advertising, on-line advertising, custom campaigns for particular employers, local advertising, billboards and/or sponsorship/PR campaigns.
Selection	Registration and interview of applicants, collection and verification of relevant documents, introducing awareness of and providing for diversity amongst and offering assurance of equality of opportunity to candidates.
Assessment	This can be carried out through a firm's own assessment system (for example, Adecco's Xpert assessment system carries out computerised evaluation, testing and training of candidates) and/or customised evaluation in assessment centres.
Training	Recruitment agents sometimes provide a training facility such as the provision of short courses on common themes such as computer, management and customer service skills.
Deployment	Many agents provide a briefing to candidates before commencing employment. This may include, for example, information on company

	policies, functions of the department in which the candidate will work and information on their specific role. The practicalities of this service may vary depending on the client preferences.
Time capture	Where the agent is monitoring working hours and paying the candidate accordingly, recruitment firms typically offer multiple methods for time capture including paper and web timesheets and swipecard systems.
Payroll	Recruitment agents pay temporary and many contract workers on a weekly or monthly basis.
Billing	Many agents offer both paper and electronic invoicing options, and consolidated invoicing for employers with contracts with several employees.

Source: based on information from Adecco website

E.20 The internet is becoming increasingly important in the recruitment industry and, recognising this, recruitment companies are now also using the internet to advertise vacancies alongside printed advertising.

Key market players today

E.21 According to the Recruitment & Employment Confederation (REC), the recruitment industry is more fragmented in the UK than in most other parts of Europe. Low barriers to entry and the common practice for staff to leave a recruitment company and start another one mean that the number of firms is continually changing. Consequently, the largest 10 firms do not control more than 15 per cent of the market.[120]

E.22 The UK recruitment industry includes a number of very large companies and a significant fringe of small to medium-sized firms. Table E.2 shows the top recruitment agents in the UK by turnover.

Table E.2 – Top recruitment agents in UK by turnover

1	Hays PLC
2	Adecco Holdings (UK) Ltd
3	Manpower PLC
4	Vedior UK
5	Spring Group PLC
6	Reed Executive PLC
7	Nestor Healthcare Group PLC
8	The Corporate Services Group PLC
9	Pertemps Recruitment Partnership Ltd
10	Modis Professional Services

Source: Recruitment International, August 2005

[120] Source: 'Recruitment Agencies: Temporary and Contract', Keynote Market Report, 2006.

E.23 However, as most of the top twenty firms operate in the permanent, as well as temporary and contract, recruitment market,[121] and may earn a relatively large share of their revenues from the permanent recruitment sector, it may be more appropriate to consider the number of temporary and contract workers placed as an appropriate measure (see Table E.3).

Table E.3 – Top recruitment agents in UK by placements

Agency	No. of temp/contract workers
Allied Healthcare	45,000
Adecco	35,000
Hays	30,000
Manpower	25,000
Reed Executive	24,000
Corporate Services Group	22,000
Nestor Healthcare Group	20,000
Vedior UK	18,500
Kelly Services (UK)	18,000
Pertemps	15,000

Source: Recruitment International, August 2005

E.24 It is perhaps worth noting, however, that marked differences in terms of the relative position of recruitment agencies when

[121] Some of the largest firms are also involved in other activities. For example, Capita Business Services Limited is involved in providing training in addition to its recruitment role.

measured by turnover and by the number of placements may also reflect sector specialisation, and differences in wages and salaries across sectors. The most notable case is Allied Healthcare, who placed the greatest number of temporary and contract workers by a large margin, but is only in 17th position when measured by turnover amongst recruitment agents.

Use of commission rates

Current charging structures and levels

E.25 Employment agencies earn their income from:

- fees from the placement of permanent staff (these fees range from 12.5 per cent to 30 per cent of annual starting salary)
- mark-up on salaries paid to temporary staff, and
- fees for managed services.[122,123]

E.26 Anecdotal evidence suggests that commission rates charged to employers are calculated on a case by case basis. That is, in general recruitment consultancies set terms and conditions which can be negotiated for each position that enables them to cover:

- direct costs – the costs of providing the service, to the desired level of quality, including staff bonus/commission/profit-share
- indirect costs – overheads, including staff salaries, training, marketing, advertising, premises, etc, and

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122 Source: 'Employment Agencies', Mintel Market Intelligence, October 2004.

123 Managed services to clients either provide a complete recruitment service for a client for a fixed term, or service and entire business function. This involves staff in various functions and may involve recruitment, selection, induction and staff development.

- a target profit margin.[124]

E.27 Agents set a general fee structure to cover these costs based on the sales levels they expect to achieve. Within this charging structure, individual agents have the discretion to negotiate with clients. General guidelines are set within agencies on both how to set commissions, and the scope for varying this commission rate. Such guidelines may include, for example, circumstances under which it may be appropriate to negotiate on set fees if there is the opportunity to win sufficient volumes of business, given that a high amount of business from one source could be more profitable than a low volume of placements for a number of different clients. Another important guideline is to remain consistent with the pricing of placements for clients of equal value, given the principles that maintaining good relations with employers is very important in this sector, employers tend to make themselves aware of the terms other employers are getting for the same services, and clients feel aggrieved when not receiving the same terms as other equal value clients.

E.28 Negotiation on fees can be either formal or informal. Informal negotiations are tailored to each client, though arguably they make it more difficult for staff to adhere to a fee structure with pricing becoming inconsistent over time. Conversely, formal processes can make negotiations seem more fair and transparent and staff are clear on the firm's charging policy. However, some negotiations will inevitably not fit well with any given structure. Negotiation also takes place regarding the level of service to be

[124] 'Why negotiate?', Walker, D. in Recruitment Matters, June 2006.

provided, payment terms, the speed of response and feedback from the client and the frequency of rate reviews.[125]

E.29 Recruitment agency staff are generally paid a salary plus a commission based on the number of appointments they can fill and the number of clients they bring to the business. Commission-based earnings are considered to be a key method of motivating staff and, in an industry where staff turnover is high, retaining them. According to the Heywood Associates' Recruitment Salary Survey 2006, commissions and/or bonuses vary between industry sectors and range between 20 per cent and 40 per cent of personal billings/margins incorporating basic salary. Nearly every sector of the market has reviewed its payout policy this year. The higher percentages relate exclusively to above threshold revenue generation and may be subject to various revenue triggers. The average gross take-home pay of recruitment agents ranges between 22 per cent and 33 per cent of personal fee income.[126]

E.30 Thus, commission rates are used in the recruitment sector for charging clients as well as remunerating agency staff. Staff costs represent a high proportion of total costs for an employment agency, and charging customers a commission helps to align revenues with costs. The ability of staff to negotiate the level of commission would indicate that competition can impact fees where there is a distortion in the effort/revenue balance for a particular contract.

Historic charging structures and levels

E.31 It is prohibited by the Employment Agencies Act 1973 to charge a worker a fee for finding them a job, with the exception of those in the entertainment and modelling sectors. It has therefore been

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[125] 'Why negotiate?', Walker, D. in Recruitment Matters, June 2006.

[126] Source: 'Recruitment Salary Survey', Heywood Associates, 2006.

the employer who directly pays for the service provided by employment agents in filling employer vacancies for a considerable period, though clearly the cost will ultimately be shared with the employee in the form of a lower salary, and the split will depend on the scarcity of particular skills.

E.32 With regard to the structure of fees, the use of commission rates has been in place for a prolonged period. This is probably due to the fact that these rates are reflective of the cost of internal remuneration of staff.

F SUPPLEMENTARY: GLOSSARY OF TERMS ON FINANCIAL ADVISORY SERVICES

Annuity

F.1 The payment of a regular income by a life company to an annuitant in exchange for a lump sum either for life or shorter periods.

Bancassurance

F.2 The selling of insurance policies by banks and building societies, through wholly-owned subsidiary companies of these, rather than by insurance companies.

Better Than Best Rule

F.3 Prevents an IFA owned by an insurance company from selling the products of its parent unless they are better than rival products in every respect. This 'better than best' rule is almost impossible to get around, leaving insurers that bought IFAs to benefit from the subsidiary's profits, but not extra sales of their products.

CAT ISA

F.4 The Treasury has drawn up guidelines on charges, access and terms, known as CAT Standards. CAT marked ISA's comply with the CAT standards and have been awarded a CAT mark. The CAT marked ISA does not represent a government endorsement of that product and the CAT standards guidelines are voluntary for ISA providers.

F.5 However, the introduction of the stakeholder suite of simple, low-cost, risk controlled savings and investment products on 6 April

2005 means that the voluntary CAT standard has been discontinued for the marketing and sale of ISA products since 6 April 2005.

Collective Investment

F.6 An investment fund, such as a unit trust, investment trust or OEIC, that pools together the money of thousands of investors and invests it on their behalf.

Critical Illness

F.7 Insurance coverage that provides a lump sum payment upon first diagnosis of a covered 'critical illness.' Covered critical illnesses are: cancer, carcinoma-in-situ, heart attack, stroke, end stage renal disease, major organ transplant surgery, quadriplegia, coronary artery bypass surgery, balloon angioplasty, stent, or laser relief obstruction procedures.

Defined Payment System

F.8 A defined payment system requires an upfront agreement between the customer and the IFA which defines, in advance, the amount to be charged. This charge could be calculated in a number of ways and is not a fixed price for every customer. It could be a fixed total charge, a fixed regular charge (a 'retainer' fee), an hourly rate or an annual percentage of funds for portfolio management activities. In return for the payment, the IFA must agree either to:

- rebate any commission payable into the customer's investment product
- offset any commission received against the fee payment due, or
- pay any excess commission directly to the customer.

F.9 A fee conditional on the purchase of a product would be regarded as commission.

Depolarisation

F.10 The rules regarding the provision of financial advice have changed since 1 June 2005 to facilitate competition in the market. This process is referred to as depolarisation. Following depolarisation, advisers can be independent (offering advice on the whole of the market), multi-tied (advising on the financial products of a panel of providers), or tied (promoting the products of just a single provider).

F.11 Under the depolarisation legislation, FAs must disclose the commissions they receive in a menu which compares the maximum commission received by the adviser with the market average commission levels for each product.

Endowment

F.12 An endowment policy is a life insurance policy which pays a sum of money after an agreed period of time, or on the death of the life insured, whichever happens first.

Executive Pension Plan

F.13 A pension plan which is tailored for directors and senior executive staff.

Growth Bond

F.14 A bond which gives capital growth at maturity.

Guaranteed Income Bond

F.15 A bond in which a single premium secures a guaranteed regular income until maturity at which time the original premium is returned.

Guaranteed Growth Bond

F.16 A bond in which a single premium secures a guaranteed amount at its maturity date.

Independent Financial Adviser (IFA)

F.17 Financial advisers that provide independent advice on the whole of the market. They must give their customers the option to pay for advice through fees alone.

Income Bond

F.18 A bond which provides income over its life and at maturity the original investment is returned.

Income Drawdown

F.19 A facility which allows a delay in buying an annuity if rates should be low when retirement age is reached. Drawdown allows putting off buying an annuity to a maximum age of 75, giving an income directly from the pension fund in the meantime.

Indemnity

F.20 A legal exemption from the penalties or liabilities incurred by any course of action. An insurance contract sets out terms and conditions specifying the amount of coverage (compensation) to be rendered to the insured, by the insurer upon assumption of risk, in the event of a loss, and all the specific perils covered against (indemnified), for the term of the contract.

Indemnity Commission

F.21 Where a life company pays commission to an agent, the company does so on the proviso it will be entitled to take back some or all of the commission if the policy is cancelled within a given period. Also known as 'clawback'.

Initial Commission

F.22 Written as a percentage of the value of new business, paid to the adviser in the initial period and can be in the form of non-indemnity commission (paid as the premium is received, not subject to clawback) or indemnity commission (paid up-front but subject to clawback).

Initial Disclosure Document (IDD)

F.23 The IDD is a document that firms are required to give to customers to provide them with key information about the services offered by the adviser and the status under which it operates (independent, tied, multi-tied etc).

Insurance

F.24 A contract in which payment of premiums covers the insured against something which may, or may not occur. For example motor insurance covers the insured against accidents which may occur. In the UK insurance is differentiated from assurance (life assurance) which is protection against something which will inevitably occur.

Insurance Bond

F.25 An insurance bond (or investment bond) is a single premium life assurance policy for the purposes of investment.

F.26 Due to tax laws they are a common form of investment in the UK and some offshore centres.

F.27 Traditionally insurance bonds were with-profits policies and were often called with-profit(s) bonds. Since the introduction of unitised insurance funds they have often been marketed as unit-linked bonds or investment bonds.

Investment Bond

F.28 A unit linked single premium whole of life assurance policy. Part of the premium gives life cover whilst the balance is invested in unitised funds. Under certain circumstances, since the bond is a life policy, certain tax advantages may be enjoyed. For example if the capital and annual interest are reinvested in full, there is no immediate liability to higher rate tax. If the proceeds of the bond are subsequently taken when a former higher rate taxpayer has become a basic rate payer, there is no higher rate tax liability.

LAUTRO

F.29 The Life Assurance and Unit Trust Regulatory Organisation (LAUTRO) was introduced in July 1988 to help minimise the potential detrimental effects of commission. However it was abolished in December 1989 after the Office of Fair Trading (OFT) concluded that the agreement limited information to consumers resulting in restricted and distorted competition.

F.30 LAUTRO is now part of the Personal Investment Authority (API), a directorate of the FSA.

Life Assurance

F.31 An insurance policy which, in return for the payment of regular premiums, pays a lump sum on the death of the insured. In the case of policies limited to investments which have a cash value, in addition to life cover, a savings element provides benefits which are payable before death.

Menu

F.32 Document issued by financial advisers which indicates the cost of advice to consumers, as well as setting out payment options: fees, commission or a combination of the two. If part or all of the charges are paid by commission the adviser must also include a market average commission figure as calculated by the FSA.

Net Present Value

F.33 The future stream of benefits and costs converted into equivalent values today. This is done by assigning monetary values to benefits and costs, discounting future benefits and costs using an appropriate discount rate, and subtracting the sum total of discounted costs from the sum total of discounted benefits.

F.34 Specific details of FSA's calculation of NPV can be found in the Conduct of Business (COB) Annex: cob4 annex 8G.

Open Ended Investment Companies (OEIC's)

F.35 Hybrid investment funds that have some of the features of an investment trust and some of a unit trust.

F.36 Like investment trusts, OEICs are companies that issue shares on the London Stock Exchange, and which use the money raised from shareholders to invest in other companies. Unlike investment trusts, they are open-ended which means that when demand for the shares rises the manager just issues more shares. With an investment trust, if demand exceeds supply, the response may be a rise in the share price.

F.37 The price of OEIC shares is determined rather differently. More like a unit trust, in fact, with the key factor being the value of the underlying assets of the fund. But in contrast to unit trusts, there is no bid/offer spread with OEICs, so the price of the shares should be the same whether you are buying or selling.

F.38 OEICs are popular on the continent but were only launched in the UK in 1997. There are around 300 up and running, with a wide range of investment objectives. You can put an OEIC into an ISA.

Packaged Investment Products

F.39 Packaged investment products include life policies, personal pensions, collective investment schemes and investment trust savings schemes.

Permanent Health Insurance

F.40 A policy which will provide an income in the event of a long-term absence from work because of illness or disability; income ceases upon return to work, retirement or death.

Personal Pension

F.41 Payment made into the pension fund is invested until the individual retires. The pension fund accumulated is then used to purchase an annuity which gives regular payments until death.

Polarisation

F.42 A set of rules set by the regulatory authority about the way some savings and investments can be sold. Advisers on life assurance, personal pensions and unit trusts either have to be independent and advise across all products and companies on the market, or they have to represent just one company and sell only the products of that provider. The rules came into effect in 1988 and apply to life policies, pension policies and collective investment schemes and investment trust savings schemes whether held in a PEP, ISA or otherwise.

Product Bias

F.43 In advertising across the range of products, tied advisers or IFAs could recommend a product type because it offers the highest rate of commission, and not because it is the best option for the buyer.

Provider Bias

F.44 Within a particular product type, IFAs could recommend the provider that pays them the highest commission, even though other providers' products offer better terms to the consumer. This can arise if the adviser chooses from across the whole market, or if the adviser uses a recommended panel that maximises commission, even if the adviser is then unbiased in selecting from the panel.

Rebate

F.45 A rebate may be offered by the adviser to the buyer, particularly in the case where an execution-only service is being provided. When an adviser charges a flat fee to the buyer and also receives commission from the provider, the adviser will often offer the buyer a rebate whereby a proportion of the commission paid to the adviser will be returned to the buyer and usually put into the investment in order to reduce the total cost to the buyer relative to the investment.

Reduction in Yield

F.46 Reduction in yield (RIY) is the difference between actual yield on the product and the yield that would have been enjoyed by the customer if there were no charges.

Regular Premium Products

F.47 Regular premium products are products paid for in recurring instalments over the term of the policy at intervals specified by the policy. Examples include pensions, and other life based savings products.

Renewal Commission

F.48 Adviser remuneration that is payable after the initial period and rewards the intermediary for persistent business. It is based on each premium paid on regular premium contracts.

Single Premium Products

F.49 Single premium products are paid for by the customer in a single lump sum. Examples include life annuities and pensions.

Small Self Administered Pension Scheme (SSAS)

F.50 A pension scheme which is defined as having less than twelve members who are connected with another member, trustee or employer, the assets of which are invested other than wholly in insurance contracts. It is an approved occupational pension scheme and is primarily suited to owner managers.

Stakeholder Pension

F.51 On offer from April 2001, stakeholder pensions aim to provide a low-cost, transparent and flexible way for people to save for their retirement.

- £3,600, including basic rate tax relief, can be invested in the stakeholder pension each year

- Basic rate tax – worth 22 per cent - will be claimed on behalf of the pension holder by the pension company running the pension. So the maximum paid is actually £2,808 per year.

F.52 Money invested in stakeholder pensions will be invested in the stock market. On retirement a quarter of the accumulated capital can be taken out as a tax-free cash sum, and the rest has to be used to buy an annuity which pays the retirement pension. Following Government standards, Stakeholder providers can only charge one per cent for managing your money. Minimum contributions into the pension are £20 and you can make payments whenever you choose.

Term Assurance

F.53 Life Insurance set up over a specific period, for example to correspond with the term of a mortgage. In the event of death during the life of the policy a cash tax free lump sum is paid out. A critical illness option can be included on term assurance.

Tied Financial Advisers

F.54 Financial Advisers who advise customers on the products of a single product provider.

Trail Commission

F.55 Commission paid annually to IFAs on top of a commission for set-up.

Unit Linked Policy

F.56 A life assurance policy in which a portion of the premium is used to purchase life cover (the sum assured) with the balance invested in an authorised unit trust/trusts. The return on the policy is thus linked to the performance of the units in the unit trust. Unit linked policies include single premium bonds or investment bonds, unit linked endowment assurance and unit linked whole life assurance.

F.57 A pension plan in which members' contributions are used to purchase units in an authorised unit trust.

Unit Trust

F.58 Unit trusts are collective funds which allow private investors to pool their money in a single fund, thus spreading their risk, getting the benefit of professional fund management, and reducing their dealing costs.

Whole of Life

F.59 Life insurance which provides coverage for an individual's whole life, rather than a specified term. Premiums may be paid throughout life or for a shorter period.

G SUPPLEMENTARY: GLOSSARY OF TERMS ON PRIVATE CLIENT STOCKBROKERAGE

Bargain size

G.1 The term 'bargain' is used on the London Stock Exchange to describe a share purchase or sale. The term 'bargain size' refers to the size of such a share trade.

Block trading

G.2 A term used by the London Stock Exchange to denote that a transaction was reported using the block trade facility, which is:

- at least 75 times the Normal Market Size (NMS) for a security with an NMS of 2,000 shares, or
- above 50 times the NMS for a security with an NMS of 1,000 shares that is, a very large transaction.

CREST membership

G.3 CREST is an electronic system of settlement for the equities market in the UK and Ireland which was set up in 1996 to replace the Stock Exchange's Talisman system. For the 1,000 largest companies on the London and Irish markets, CREST matches trades against payments and tells the company's registrars what names to add to the share register and which ones to delete. It eliminates the need for constant passing around of paper certificates. Shareholders can opt into CREST by having their shares registered in the name of a nominee service offered by their broker. Many on-line brokers will only deal with clients who are willing to adopt the nominee system.

- the broker sets up a special company called 'XYZ Nominees Ltd'

- ownership of all client shares is registered to the company, and the company holds the share certificate, but beneficial ownership is recorded in the client's name

- the broker sets up internal systems to ensure that the client gets the dividends, and that their account statement correctly shows their portfolio holdings

- clients do not normally get the other shareholder benefits – for example, shareholder perks, reports and accounts - but some brokers can make special arrangements so that they do.

Dematerialisation

G.4 The process of converting a security from physical (paper) form to electronic form.

Market maker

G.5 A market maker is a dealer on the London Stock Exchange who acts as a wholesaler (that is, quotes buy and sell prices to brokers) for the shares in which he is registered to trade as a principal. Market makers fulfil buy and sell orders from brokers, and create a marketplace for the buying and selling of shares to match supply and demand.

Nominee account

G.6 An account in which the named holder holds the assets in it on behalf of another (the beneficiary). In the stock market, the most common use of nominee accounts is where execution-only brokers act as nominees for their clients. The shares are registered in the name of the broker, but the client has beneficial ownership of them. The advantage of nominee accounts is that they make settlement quicker and more streamlined. In theory, dealing costs should be lower. There are some disadvantages: because the individual is not the registered owner of the shares, he does not get sent company reports and accounts, and cannot take advantage of shareholder perks, unless his brokers provides a special forwarding service.

Security

G.7 A financial asset such as a share or bond.

Stock Exchange Electronic Trading Service (SETS)

G.8 SETS is the automated trading system introduced in 1997 for the largest companies quoted on the main list of the London Stock Exchange. Trades through SETS match buyers and sellers automatically, cutting out the need for a market maker which theoretically means a narrower bid-offer spread. Smaller companies continue to use the SEAQ 'quote' book system, with market makers quoting prices to brokers and trades being done on a semi-automatic rather than fully-automatic basis.

Soft commission

G.9 **Between the broker and trader** - Payment to a broker by a customer by way of commission charges for services provided rather than a fee (known as hard commission).

G.10 **Between the fund manager and broker** - Under a soft commission arrangement, the fund manager receives goods and services (usually from third parties) which are paid for by the broker. There is an explicit prior agreement that links the value of the softed goods and services to a specified volume of commission from dealing orders.

H SUPPLEMENTARY: COMPETITORS TO EBAY

Table H.1 - Items available on AVABID

Category	Number of items
Antiques	492
Beanie babies	578
Books/magazines	677
Clothing and accessories	562
Coins/Stamps	257
Collectibles	1452
Computer software	1139
Electronics & cameras	242
Entertainment	2369
Equipment & Tools	28
Home & garden	391
Jewellery	638
Miscellaneous	296
Mobile phones	171
Music	194
Office equipment & stationary	79
Sports	370
Toys & hobbies	659

Trading cards	1581
Travel & Transport	622

Source: www.avabid.co.uk, 13 May 2006

Table H.2 - Items available for auction on E-BID

Category	Number of items
Antiques & art	1068
Auctions for charity	369
Books & magazines	9798
Business, Office & industrial	289
Computing	2117
Consumer Electronics	2463
Crafts & sewing	4263
Sporting goods	1663
Cars & vehicles	880
Classifieds	60
Clothing & accessories	11383
Health & beauty	2251
Home & garden	3952
Tickets & travel	91
Toys & hobbies	4026
Collectables	33477
Jewellery & watches	11559
Movies & DVD	6490
Music & CD	73573

Photography	276
Video & computer gaming	1662
Whatever's left	2458
Wholesale & large lots	521
Spirituality & Metaphysical	1620

Source: www.ebid.co.uk, 13 May 2006

Table H.3 - Items available on CQOUT

Category	Number of items
Arts & Antiques	1466
Beanies & collectable bears	101
Books, Comics, Magazines	5502
Collectables	4287
Consumer electronics	1095
Computer hardware	7699
Computer software	2196
Crafts, Arts & hobbies	148
Fancy dress & party gear	358
Fashion, clothing, shoes	5346
Films & video	14604
House & garden	1480
Jewellery & watches	8295
Miscellaneous	1039
Motoring	713
Movie Memorabilia	16082
Music	50777
Office equipment	485
Photographic equipment	253

Sports & recreation	585
Tickets, Seats, Late availability	25
Tools, hardware & DIY	323
Toys, models & games	2890
Video & PC Gaming, consoles	1594
X-rated & adults only	14443
Business to business	334
Charity auctions	59

Source: www.cqout.co.uk, 13 May 2006

Table H.4 - Items available on BUYIT

Category	Number of items
Antiques & art	0
Automotive	6
Books	22
CDs, records & tapes	2
Clothing, shoes, accessories	13
Collectables	4
computer & video gaming	3
Computing	36
Consumer electronics	1
DVDs	5
Industrial, office & wholesale	1
Jewellery & watches	47
Mobile & home phones	1
Music	0
Photography	6
Sporting	2
Stamps	1
Tickets & travel	2
Toys, Bean bag plush	0

TV, Video & film	1
Everything else	5

Source: www.buyit.co.uk, 13 May.co.uk

Table H.5 - Items available on QXL

Category	Number of items
Automotive - vehicles	11
Automotive - Accessories	32
Antiques & art	63
Books	234
Charity	1
Clothing & accessories	526
Collectables & toys	663
Computing & software	309
Football	710
Gaming	163
Gifts	38
Home electrical & photographic	72
Home & outdoor living	380
Jewellery & watches	511
Music & movies	20391
Mobile & home phones	110
Over 18s	6322
Property/real estate	12
Sports & Fitness	240

Stamps & coins	2647
Travel	8
Other	64

Source: www.qxl.co.uk, 13 May 2006

Table H.6 - Items available on AUCTIONZONE

Category	Number of items
All	0

Table H.7 - Items available on HUNT for IT

Category	Number of items
Adult	2285
Antiques & Art	8
Archive	1
Artists Contemporary bands	1
Automotive	2475
Baby	12
Books, comics & magazines	2102
Business, Office & industrial	543
Clothes, shoes & accessories	213
Collectables	9
Computing	4586
Consumer electronics	1343
Crafts	614
Dolls & bears	85
DVD, Film & TV	873
Everything else	261
Health & beauty	224
Home & garden	260
Home & mobile phones	93
Jewellery & watches	3651
Music	8831
Musical instruments	3

PC & video gameing	889
Photography	4
Pottery, Porcelain & glass	3
Sporting goods	294
Sports Memorabilia	3
Stamps	1
Tickets & travel	1
Toys & games	991
Wholesale & job lot	10

Source: www.huntforit.co.uk

I SUPPLEMENTARY: DTI REGULATIONS (2003) ON TEMPORARY & CONTRACT EMPLOYMENT AGENCIES

General obligations

Regulation 5	Restriction on agencies and employment businesses requiring work-seekers to use additional services
Regulation 6	Restriction on detrimental action relating to work-seekers working elsewhere
Regulation 7	Restriction on providing work-seekers in industrial disputes
Regulation 8	Restrictions on paying work-seekers' remuneration
Regulation 9	Restriction on agencies and employment businesses purporting to act on a different basis
Regulation 10	Restrictions on charges to hirers
Regulation 11	Entering into a contract on behalf of a client
Regulation 12	Prohibition on employment businesses withholding payment to work-seekers on certain grounds

Requirements to be satisfied before services are provided

Regulation 13	Notification of charges and the terms of offers
Regulation 14	Requirement to obtain agreement to terms with work-seekers
Regulation 15	Content of terms with work-seekers: Employment businesses
Regulation 16	Content of terms with work-seekers: Agents
Regulation 17	Requirements to obtain agreement to terms with hirers

Requirements to be satisfied before a work-seeker is introduced or

supplied to a hirer

Regulation 18	Information to be obtained from a hirer
Regulation 19	Confirmation to be obtained about a work-seeker
Regulation 20	Steps to be taken for the protection of the work-seeker and the hirer
Regulation 21	Provision of information to work-seekers and hirers
Regulation 22	Additional requirements where professional qualifications are required or where work-seekers are to work with vulnerable persons

Special situations

Regulation 23	Situations where more than one agency or employment business is involved
Regulation 24	Situations where work-seekers are provided with travel or required to live away from home

Client accounts and charges to work-seekers

Regulation 25	Client accounts
Regulation 26	Circumstances in which fees may be charged to work-seekers

Miscellaneous

Regulation 27	Advertisements
Regulation 28	Confidentiality
Regulation 29	Records
Regulation 30	Civil liability

Regulation 31	Effect of prohibited or unenforceable term and recoverability of monies
Regulation 32	Application of these Regulations to work-seekers, which are incorporated
Regulation 33	Electronic communications