

# models of self-regulation

**An overview of models in business and the professions**

#### About the National Consumer Council

The purpose of the National Consumer Council is to make all consumers matter. We do this by putting forward the consumer interest, particularly that of disadvantaged groups in society, by researching, campaigning and working with those who can make a difference to achieve beneficial change. We are a non-profit-making company limited by guarantee and funded partly by the Department of Trade and Industry.

Our objectives are to work to:

- Create smart, streetwise, skilled consumers by promoting access to high quality education, information and advice;
- Develop markets and public services that work for everyone by finding the right balance between free markets, regulation and self-regulation;
- Provide solutions to the problems of exclusion by tackling the barriers that put goods and services out of reach;
- Ensure decision-makers everywhere are consumer aware by strengthening consumer representation;
- Achieve the right balance between innovation and consumer protection by improving the understanding, communication and management of risk and uncertainty.

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#### About this discussion paper

Along with other consumer and regulatory organisations, the National Consumer Council has had extensive experience over many years of observing, assessing, commenting on, and to some extent participating in, self-regulatory arrangements of various kinds.

This paper draws on that experience to review the principles and practice of self-regulation in the UK today (see chapters 2, 3 and 4), and to set out some guidelines on the planning and implementation of effective self-regulatory arrangements (see chapters 5 and 6).

#### Acknowledgements

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It is based on a draft written for the National Consumer Council by Richard Thomas, director of public policy at Clifford Chance. In 1986 he wrote the forerunner to this paper, *Self-regulation of Business and the Professions*, while legal officer for the National Consumer Council.

We are very grateful to Richard, and to Clifford Chance, for the work on this report.

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# 1. Models of regulation: from self-regulation to regulation

## **Regulation of markets: the background**

The National Consumer Council's approach to the analysis of issues affecting consumers is rooted in the presumption that consumers are the best judges of their own interests – making decisions, exercising choices and having real influence as buyers and users of goods and services. Lively competition plays a vital part in contributing to positive outcomes. Despite the evidence of significant consumer dissatisfaction in particular areas, it is important to recognise that tens of millions of transactions take place every day, which leave most consumers satisfied with most things most of the time. Care must always be taken not to propose or support intervention which will be counter-productive, or otherwise produce undesirable results.

But, if a well-developed competitive market is necessary to achieve widespread consumer satisfaction, it is not – and cannot be – sufficient by itself. Markets also need to be strengthened and supplemented with regulatory intervention to provide for matters important for consumers which the market cannot deliver.

## **The justification for regulation**

Regulation of any kind is a means to an end, not an end in itself. It provides a means of achieving defined goals, by adopting rules directed at shaping conduct or controlling behaviour in some way, and then putting machinery in place to enforce those rules.

The starting point, therefore, for any review of regulation must be with policy objectives. Why is there a need for some form of intervention in the market place? What is the mischief we need to deal with? What standards do we need to raise? What policy objective are we pursuing? What is the public good we seek? What do we want the rules to achieve?

Any intervention, whether legal or self-regulatory, must be justified by reference to issues such as:

*Inadequate competition* – where suppliers, individually or collectively, dominate the market or make arrangements which reduce competition and consumer choice.

***Fraud, deception and oppressive marketing practices*** – where suppliers take advantage of consumers in ways that are illegal or unfair.

***Imperfect information*** – where the information essential to informed consumer choice is either completely unavailable, or false or misleading.

***Safety*** – where there is risk of consumers using goods or services which may damage their health.

***Resolution of disputes and the pursuit of redress*** – where easily accessible procedures are needed to make sure consumers can get a remedy for breaches of contract or other laws or codes.

***Externalities*** – where there is a need to ensure that the costs of producing goods and services reflect all the consequences of their production (as with pollution).

***Social objectives*** – where the market is unable to make socially desirable goods and services available for defined groups of consumers. Also, where an unregulated market is unlikely to achieve democratically desirable results relating to public order, taste and decency, and similar goals.

***Vulnerable consumers*** – for example, those with weak bargaining power and children may need special or additional protection.

***Raising standards*** – in a sector where businesses can gain a competitive advantage or where there are known to be problems with compliance with the law.

While the National Consumer Council's focus is on the consumer interest, some of the issues listed above obviously relate to broader social policy objectives. For example, regulation is needed to protect the health and safety of workers and while this may have a cost for consumers in higher prices, it is not otherwise specifically related to consumers' interests. Regulation of taste and decency is another example.

## **Ebbs and flows in policy**

While there might be broad agreement on the fundamental reasons for intervening in markets, there is inevitably debate about the precise nature of that intervention in relation to particular circumstances in a particular market. Is intervention really the best way to achieve a given objective? If so, what type of regulation is needed? One type is self-regulation.

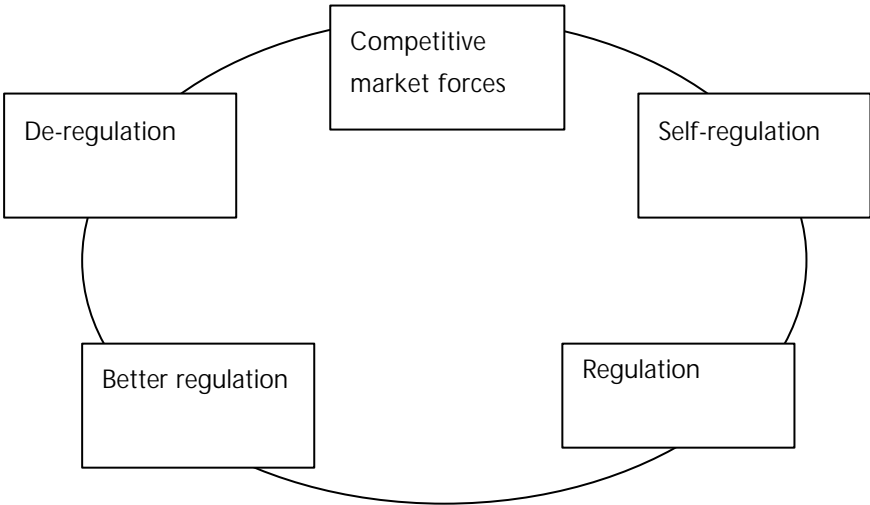
Self-regulation means in essence that rules which govern behaviour in the market are developed, administered and enforced by the people (or their direct representatives) whose behaviour is to be governed.

Self-regulation is usually, but not necessarily, a collective activity, involving participants from a market sector who agree to abide by joint rules, much like a club membership. It is also (at least nominally) voluntary, with benefits perceived for those who participate.

In practice, as we shall see, the two forms of self-regulation – legal and voluntary – are by no means mutually exclusive or even complete opposites. Moreover, there is often considerable outside pressure to self-regulate. And there are many ways in which independent interests can, and should, have an influence on self-regulatory arrangements.

Most would agree that fraud and deception demand *legally* binding rules of universal application. But in other areas, there are ebbs and flows in attitudes and policy towards regulation. At any given time, one approach is more likely be favoured over another. The graphic below shows the various approaches.

### The ebbs and flows of market intervention



Debates about the appropriate level and nature of intervention draw in a wide range of interests – from businesses and their organisations, through consumer organisations and regulatory bodies, to the media, economists, lawyers and ultimately politicians and law-makers. Today all interests are likely to be guided by some broad, basic principles, such as those articulated in the *Better Regulation Guide* launched by the government in 1998. These principles are outlined in the box below.

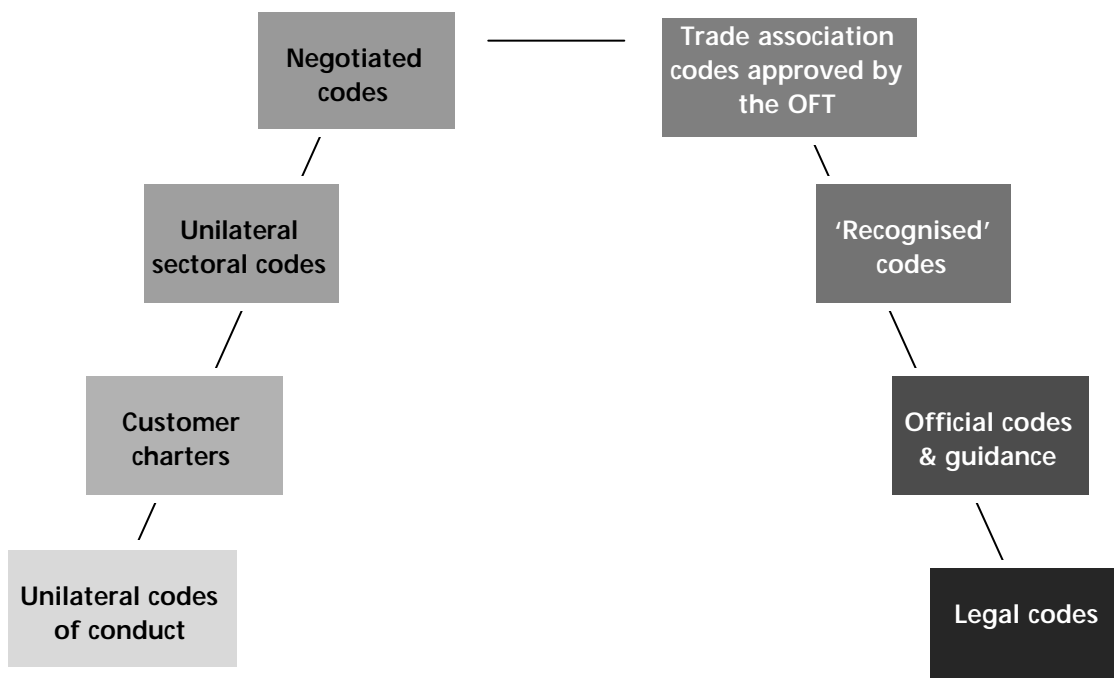
#### Good regulation: the government’s key principles

- Transparency:** be open, keep it simple, be user-friendly.
- Accountability:** to government ministers and parliament, to users, to the public.
- Targeting:** regulation should focus on the problem, and minimise side-effects.
- Consistency:** be predictable, people should know where they stand.
- Proportionality:** fit the remedy to the risk, only regulate when you need to.

## 2. The self-regulation spectrum

In this chapter we give shape to the countless number of self-regulatory arrangements currently in use, in order to highlight the differences between them and to demonstrate how self-regulation can shade into the regulatory framework. While it might be possible to classify self-regulatory systems according to legal effect or to motivation, we use the simpler approach – classifying them according to how they have been adopted. At the end of the chapter we summarise the features they have in common.

Using this classification, we can identify eight main types of self-regulatory arrangement that fall broadly along a spectrum:





In this chapter and others, we use the word 'code' to mean any set of self-regulatory rules falling short of primary or statutory legislation.

Appendix 2 contains a list of self-regulatory schemes affecting consumers, ordered according to this classification, although in some categories we have not given examples. This list is not comprehensive. It merely gives an idea of the range of areas covered.

### **Unilateral codes of conduct**

At one end of the self-regulation spectrum is the individual business which decides to adopt and implement specific policies which amount to some form of self-restraint on its conduct towards its customers. In a sense this is the 'purest' form of self-regulation.

A business may adopt a course of conduct of this kind for competitive advantage, to deflect criticism, to persuade legislators that the business gives no cause for concern, to promote its reputation in the eyes of its staff and other stakeholders, or to pursue goals of social responsibility. The policy may be vigorously promoted to customers and others, or it may remain an entirely internal matter. There are numerous examples of this type of self-regulation, some of which are listed in the box on the next page.

### **Unilateral business codes of conduct: some examples**

- Direct marketing companies that allow customers to cancel an order and return goods, often refunding postal costs.
- Shops that adopt a generous returns policy (for exchange or refund).
- Price promises that offer a reduction, or sometimes a reward, if the same product can be bought cheaper elsewhere.
- Lenders that grant 'an indulgence' to those with repayment difficulties.
- Insurance companies that meet claims beyond a literal interpretation of the policy wording.
- Banks that pay fixed penalties for mistakes.
- Travel companies that offer compensation beyond the customer's entitlement when delays or other problems occur.
- Codes of ethically or socially responsible business conduct in relation to employees or the environment.

The growth of customer-friendly arrangements like these is a welcome reflection of consumer sovereignty in a highly competitive market place. In some cases the promises a business makes will be contractually binding. In others, policing (for example, through the Trade Descriptions Act or the Advertising Standards Authority) may be necessary if businesses make exaggerated or unfulfilled claims. Beyond that, however, what each business does is a matter for its own judgement.

### **Customer charters**

Customer charters take self-regulation by an individual business one step further, with a formal exercise covering all key aspects of its dealings with customers, though still stopping short of collective participation with other companies.

The customer charter, like the Citizens Charter (now called Service First) from which it derives, is a company's formal public commitment to combine compliance with its legal obligations with customer service initiatives, promising:

defined levels of performance across all the activities important to customers;

defined penalties where standards are not fulfilled;

independent auditing of the company's performance;

full and public reporting of actual performance.

Businesses claim that a charter can deliver quality and customer satisfaction on all aspects of the company's service, not simply reduce risk at the time of purchase. It 'translates every element of customer dissatisfaction into pain for the company', energises managers and staff, supplies a feedback link from customers, and forces the company to sit up and take notice of what its customers want and need.

### **An Australian customer charter**

The AAMI (Australian Associated Motor Insurers Limited) Customer Charter was introduced by one of Australia's leading insurance companies in 1996 and now sets out 17 specific promises of performance covering, for example:

- availability of decision-makers to deal with claims and queries;
- plain language documentation;
- detailed responses to all written enquiries within five working days;
- safeguarding of personal information;
- detailed promises relating to motor and household insurance;
- free and accessible internal dispute resolution procedures;
- a \$25 penalty payment for failure to meet any promise.

The company's performance is audited by KPMG and an Annual Report is published documenting performance against standards, the nature and extent of penalties paid and details of the audit process.

### **Unilateral sectoral codes**

It is ironic that the next point along the spectrum has all the characteristics of 'genuine' self-regulation – entirely voluntary, self-imposed, collective – but in practice is almost extinct. This is the code of practice or similar set of rules unilaterally adopted by a trade or profession, without any consultation or discussion with the outside world. While there have been such initiatives in the past, particularly within the professions, it is more or less unthinkable that a trade or professional organisation would set off in isolation in this way in the current climate.

But unilateral sectoral codes do still happen. It is of some concern, for example, that the Code of Practice on Electronic Commerce, produced by the International Chamber of Commerce in April 1998, seems to have involved minimal consultation with national or international consumer organisations (though it has been presented as the start of a longer process of developing self-regulation). Other examples can be found in complementary and alternative health therapies – please see the box below.

## **Unilateral self-regulation in complementary and alternative medicines**

'In the United Kingdom there has been little proscription by authority to limit the professional responses to increasing public demand for complementary and alternative medicine. As long as certain limited activities and titles are not assumed it has been perfectly legitimate for a wide range of professional practices and therapies to develop. The natural instinct for self-enhancement of professional status has also been unhindered and most practitioners have seen it to be an advantage to subscribe to organisations overtly raising standards. On the other hand there are few formal obligations to meet any particular level of standards, and it has still been possible for individuals to break away to pursue their own path, even set up their own training programme or professional body, without sanction. They do not have to submit to anyone, building their base entirely on their ability to please their customers, their patients ...

... Consumer interests demand that professional groups provide ample opportunities for members of the public to pursue complaints against practitioners both with the assurance of formal disciplinary codes, sanctions and procedures in place, and complaint procedures freely available to the public (*Health Which?*). Provision of both these was patchy among even the most established groups and few examples of publicly available complaints procedures were submitted to the survey team. It is likely that it is in this area that professional groups will wish to most confirm their professional aspirations.'

***Professional Organisation of Complementary and Alternative Medicine in the United Kingdom, a report to the Department of Health, University of Exeter, 1997***

## **Negotiated codes**

More common in the modern world of stakeholder involvement are codes of self-regulation which have been negotiated, or at least discussed (either formally or informally) between an industry body on the one hand, and government and consumer organisations on the other.

This category also includes schemes where 'public interest' or 'consumer' representatives participate in the administration of the code. Well-known schemes of this kind include:

the British Code of Advertising Practice and Sales Promotion and its enforcement arrangements;

the ombudsman schemes set up across the financial services industry and for estate agents and funeral directors;

the regulation by ICSTIS (the Independent Committee for the Supervision of Standards of Telephone Information Systems) of premium rate telephone calls; and

the code of practice adopted by the Association of Energy Suppliers to restrain unacceptable methods of marketing gas and electricity. This code sits side by side with the requirements of the energy regulators on marketing energy contracts (which are part of the licence conditions for energy suppliers) but it goes somewhat beyond the licence requirements.

The fact that a code has been *negotiated* with consumer or other outside bodies does not necessarily mean that consumer or other representatives are involved in its *administration*.

Also included in this category are the initiatives developed by or with local authorities (like Good Trader Schemes), where local traders can apply for some form of accreditation. Another form involves government departments promoting codes as an alternative to regulation. One example is the Code of Practice on Green Claims developed by the Department of the Environment, Transport and the Regions (DETR) – please see the box below.

### **An example of a negotiated code: Code of Practice on Green Claims**

The Department of the Environment, Transport and the Regions (DETR) launched the Code of Practice on Green Claims in February 1998 to help manufacturers and retailers avoid meaningless or misleading claims (on packaging) that a product has a positive impact on the environment. The code includes guidance on giving positive environmental information to consumers and the standard of information they can expect.

The code was negotiated with the Confederation of British Industry, British Retail Consortium, Local Authority Co-ordinating Body on Food and Trading Standards and consumer groups. Launching the code, the Environment Minister said his aim was legislation, but first he wanted to establish acceptable standards.

The National Consumer Council was given the job of monitoring whether manufacturers and retailers had been observing the code in the first year. The code's most serious shortcoming is the lack of real sanctions against those who break it. The DETR suggests that companies shown to have broken the code could be 'named and shamed'. Also, there is no mechanism to adjudicate on whether claims breach the rules, although the Minister has suggested that this role could be carried out by the advisory panel he is setting up to advise the DETR on ways of raising the standards of information available in the market. Given that this is an unpaid ad hoc advisory panel, it is hard to see how it can undertake adjudication without considerable restructuring.

There appear to be no plans for monitoring the operation of the Code of Practice on Green Claims after the first year.

### **Trade association codes approved by the Office of Fair Trading**

This category is a variant of negotiated codes and covers the 49 codes that have been drawn up by trade associations in consultation with the Office Of Fair Trading (OFT) and formally approved by the Director General of Fair Trading. We describe this mechanism in detail in chapter 4.

### **'Recognised' codes**

These are codes which have some form of statutory foundation or recognition. It includes the professional 'codes' of lawyers and doctors. The Solicitors Act empowers the Law Society to make 'practice rules' for solicitors and the General Medical Council has a corresponding power for doctors. More recently, the Financial Services Act 1986 gave authority and recognition to the Securities and Investments Board (now re-constituted in the Financial Services Authority) and to self-regulatory organisations such as the Personal Investment Authority and the Investment Management Regulatory Authority.

### **Official codes and guidance**

There are many examples of a government department or regulatory agency issuing a code or guidance (often elaborating on statutory provision), which has had self-regulatory input and is intended to be followed within the business sector in question. The 'enforcement' of such codes is left to traditional methods – in other words, civil or criminal action in the courts.

#### **Examples of official 'guidance'**

**Example 1:** 'Following a dispute that arose after the Director General of Fair Trading proposed to issue a prohibition order in respect of a breach of section 18 of the Estate Agents Act, discussions were held with the three main bodies representing estate agents . . . . This led to the Director General issuing revised guidance as to the meaning of section 18. It is of course subject to any interpretation the courts eventually may give but in the meantime it should help to clarify the position. '

**Office of Fair Trading press notice, 8 September 1988**

**Example 2:** The Department of Trade and Industry issued guidance notes on the interpretation of the Package Travel, Package Holidays and Package Tours Regulations 1992, after consulting on the interpretation with travel groups and consumer bodies. The guidance notes reinforce, but do not replace, the regulations. Again, it is the courts that are ultimately responsible for deciding on the interpretation.

### **Legal codes**



The final type of code is perhaps not true self-regulation at all, but business interests are likely to have a strong influence in negotiating the content. These are codes imposed by government or by a public authority under the authority of statute, but which lack the full force of conventional law. Official guidance from the Cabinet Office says that a Code of Practice should not 'be used to define specific legal obligation ... It may be appropriate to explain or supplement the provisions of ... legislation ... [but] ... should not be regarded as a substitute ...'

Legal codes usually have some form of status as supporting evidence. They tend to be looser in style and content than formal legislation and are not necessarily intended to be binding on every occasion. For instance, the Road Traffic Act 1988 (section 38) authorises the Department of Transport to publish a Highway Code. The Act says that 'a failure to observe ... [the Highway Code] ... may be relied upon to establish or negative any liability'. And under the Health and Safety Act 1974, an approved code of practice can effectively shift the burden of proof in criminal proceedings to the employer – the breach of a code is *prima facie* evidence of an offence.

### **The status of a legal code**

Under section 40 of the Food Safety Act 1990, the government may issue codes of recommended practice to enforcement authorities for the carrying out of their functions under the Act. Before issuing a code, ministers are required to consult those who represent interests likely to be affected by the code. Codes have been issued, among other matters, on the enforcement of meat hygiene regulations, dairy products hygiene regulations, food standards regulations and inspection procedures. Ministers can direct an authority to take steps to abide by the provisions of a code. This direction can be enforced through the courts, otherwise the codes operate as guidance.

There are now more and more examples where this final category of self-regulation has been used for consumer affairs. One of the most important examples concerns price marking. Part III of the Consumer Protection Act 1987 introduced a new *general* prohibition on false or misleading pricing, but this is backed up by a statutory Code of Practice. The Code is admissible

in evidence, but is not mandatory in itself. Although the so-called 'DTI Code' is drawn up by the Secretary of State, this must follow advice from the Director General of Fair Trading and consultation with all interested parties. Commercial interests clearly had a major influence on its final content.

### **The common features of regulatory systems**

Despite the many differences between the eight types of self-regulation described above, we can identify three elements common to most forms of regulation, both statutory and self-regulatory:

*Rules* which set out how business conduct is to be judged.

*Monitoring and enforcement* of the rules.

A *redress* system for consumers who have suffered loss, through breach of the rules.

The three elements may not always be provided for in one system but, unless all three are covered somehow, the regulation is unlikely to be effective.

In a unilateral business code of conduct scheme (see page 8), the business is free to 'make up' the rules on its own because they represent an advance on statutory requirements. However, the nearer we get to statutory regulation, the greater input there is likely to be from outside bodies, including government, into what the rules should be.

In the systems nearer to 'pure' self-regulation, monitoring, enforcement and redress may be weak or non-existent. Monitoring and enforcement, if carried out at all, may be left to local trading standards departments through the Trade Descriptions Act 1968 and its criminal sanctions, or to the Advertising Standards Authority. So under these circumstances, redress will not be available unless the promise amounts to a contract term, when the consumer will have to rely on action in the civil court.

Schemes further along the spectrum towards statutory regulation are more likely to incorporate monitoring, enforcement and redress, though there may be differences in how much input outsiders make to the scheme's operation. But with official and legal codes, once again the enforcement is usually the preserve of statutory bodies who have a duty to enforce the

legislation. This gives rise to the need for interpretative codes. Here again, redress may be unavailable – unless the legislation provides for it, when consumers will have to seek compensation in the civil court.

### 3. Legal and voluntary rules: the arguments for and against

The arguments in support of self-regulation as a way of controlling business behaviour often focus on the disadvantages (both actual and perceived) of the 'alternative' method – legislation. While it can be artificial, and indeed dangerous, to draw too sharp a distinction between the two, this chapter summarises the arguments commonly used for and against both methods. This provides a background to the examples (in this and the next chapter) of self-regulation in action. We are not suggesting that all strengths and all weaknesses apply to each self-regulatory code and each piece of legislation, merely that any one of these might apply to any individual scheme.

#### **Legislation: the strengths**

- (a) Legally imposed rules draw *authority and legitimacy* from the democratic process. They are the principal means for achieving political objectives (in this context, setting out the nature and extent of market intervention).
  
- (b) Whether criminal, civil or administrative, their effect is *coercive*: businesses cannot choose whether to follow the rules or not.
  
- (c) They have *universal application*, applying to every business or activity within the scope of the particular rule: ignorance of the law is no defence.
  
- (d) They are *adaptable*, in the sense that their content can be as broad, or as detailed, as necessary. There are no restraints on what can be included, other than those imposed by the democratic process involved in making them.
  
- (e) They have *credibility* by virtue of their status, and by their nature (at least in principle) achieve objectives which will not result from voluntary action.

#### **Legislation: the weaknesses**

(a) There are difficulties in securing political attention and *legislative time*, both for introducing and amending legislation.

(b) Legally enforceable standards are usually written *in negative terms*, giving business an incentive to avoid breaking standards but doing nothing to promote a positive approach to satisfying the customer.

(c) Legislation written in general terms leaves too much *discretion* to businesses and regulators. But clarity and certainty tend to produce *complexity and loss of flexibility*.

(d) The comparatively minor nature of many trading offences and, often, the need for strict legal liability, make the criminal law an *unwieldy and inappropriate vehicle* for regulation. Legislation that is concerned with subjective matters, often seeking to regulate a wide variety of different commercial and organisational practices, can be particularly unsatisfactory.

(e) Legislation is *costly* in interpretation, application, and enforcement.

(f) *Law enforcement by a statutory body is no panacea*: statutory regulators can sometimes tend towards over-zealous aggression, complacency, or under-resourced impotency. Evidential, procedural and due process requirements (including those imposed by human rights legislation) can also handicap flexibility and effectiveness. And credibility can be undermined by bureaucratic delay and the threat of legal challenge from regulated businesses.

(g) Legislation can have *unintended costs or side-effects* which do not serve consumers' interests.

(h) Traditional legislative routes *cannot tackle modern forms of business practice* – for instance, telephone transactions (there is often no record of what was said or done) or the anticipated explosion in electronic commerce.

### **Electronic commerce: is self-regulation the answer?**

The huge potential of commerce via the internet will not be fully realised unless consumers can be confident they are protected from unacceptable business practices. It is argued that self-regulation has a role.

The OECD (Organisation for Economic Co-operation and Development) Committee on Consumer Policy aims to develop a set of consumer protection guidelines. They are likely to address such points as the identification and location of the business, product disclosure, cooling-off periods, privacy, security and complaints procedures. But even if the guidelines can be internationally agreed and adopted, enforcement and redress through legal means – as with all forms of international trade – present almost insuperable barriers.

Self-regulation across national borders suffers the same disadvantages as other forms of regulation. Which global body has the standing, authority and resources to secure agreement to a regulatory code, let alone enforce it?

Certification that a business complies with the OECD or other self-regulatory guidelines might seem to offer a solution, especially where the certification is provided by a reputable external body. In the UK, for instance, the Advertising Standards Authority has recently consulted on detailed proposals for a Trustmark scheme. The WebTrust scheme, launched by the international accountancy profession, has a similar goal.

Consumers' Association have developed the Web Trader scheme. This relies on a code of practice, setting standards for dealing with online consumers. Traders who join promise to observe this code. Consumers' Association investigates reports of non-compliance. The sanction available is to remove the trader from the scheme.

But all such schemes are developing in isolation from the OECD guidelines and even these have not yet been internationally adopted. There is certainly no single set of standards and no single certification body. As more and more of these schemes emerge, the risks of consumer confusion increase.

A more promising model may be the business charter, under which individual companies could show what they promise, how they arrange for independent monitoring of compliance with those promises and what redress they provide automatically if they fail to keep them.

## **Self-regulation: the strengths**

(a) Voluntary initiatives can be a flexible, cost-effective way of tackling problem areas. Self-regulation implies a clear wish by participating traders to distinguish themselves from those with lower standards. The business benefits when customers actually seek out traders who observe self-regulatory requirements.

(b) Self-regulation can not only ban detrimental practice, it can also *benchmark best practice* over and above the basic minimum requirements.

(c) An arrangement that is drawn up by, or with, members of an industry will be 'owned' by them. It will be tailor-made for the needs and problems of that particular sector, and will (at both design and enforcement stages) reflect inside knowledge about the realities of that sector.

(d) It should be *quicker and less costly* to put in place (and adapt to changing needs) than legislation.

(e) It can more easily deal with matters of subjective judgement, such as questions of decency.

(f) It can address *complex areas* – especially where common values and assumptions are shared – without attracting the disadvantages of complex legal requirements.

(g) It can put *the burden of proof of compliance* on the trader.

(h) *Redress can be achieved more quickly and cheaply* than legal remedies through civil proceedings.

(i) The *cost of self-regulation* can be laid on the trade or industry involved (although this is increasingly true of statutory regulation as well).

### **Self-regulation: the weaknesses**

(a) The outstanding drawback with a self-regulatory arrangement is that *it does not apply to those traders who are not members of the scheme*. And where there is only partial coverage, it is often those who stay outside the scheme who tend to be the main cause of consumer problems.

(b) On the other hand, of course, where there is full coverage across a business or professional sector there can be *a strong tendency towards anti-competitive behaviour*, especially where self-imposed restrictions impose barriers to entry or make it difficult for consumers to exercise informed choice. Effective self-regulation organised on any sort of collective basis involves some form of cartel-type restrictions. The more these lack any features that might bring them under the scrutiny of the competition authorities (through the Restrictive Trade Practices Act 1976 or, soon, the Competition Act 1998), the less likely they are to produce tangible and meaningful benefits for consumers. For instance, it is easy for self-regulation to lead to unnecessarily high prices. So there is a very narrow line between 'self-regulation in the public interest' and 'restrictive practices' – as examples from various professions show.

Chapter 1 of the Competition Act 1998, which concerns anti-competitive agreements, does not apply to professional rules. There is some scrutiny by the Director-general of Fair Trading, but professional rules are, in effect, treated differently from other service sectors.

The problem is less acute outside the professions. Most trade association codes do not gain automatic exemption from competition legislation – but the tendency remains. The converse is that, unless codes are approved by a competition authority, some provisions of benefit to consumers may be rejected by a self-regulatory body for fear of falling foul of competition law.



## Professionals: the fine line between self-regulation and restrictive practices

**Example 1:** It is reported that in New York in the 18th century, when lawyers had a monopoly on court practice, they decided to admit no more apprentices in training for the next fourteen years – except their own sons.

**Example 2:** Conveyancing in the UK was for many years the legal preserve of solicitors. To ‘protect the interests of consumers’, their self-regulatory rules prohibited advertising. The lifting of both rules (opening up conveyancing to non-solicitors in 1990 and progressive deregulation of advertising in the early 1980s) resulted in dramatically reduced prices for house-buying as competition increased.

(c) There can be *distortion of the market*. Non-members of a self-regulatory scheme do not have to follow the rules, so they can under-cut the market with lower standards.

(d) Even participating traders *may not take self-regulatory requirements seriously*.

(e) A plethora of codes and, often, their inaccessibility make it difficult to *educate* traders, consumers and their respective advisers about their *obligations and rights*.

(f) A *limited range of sanctions* is available for breach of self-regulatory rules. The usual sanctions would be expulsion (a step a trade association, for example, may be reluctant to take) or a fine (which seems rare in practice). Sometimes there is *no sanction*, as with the government’s present Code of Practice on Green Claims (please see chapter 2).

(g) *Public confidence may be lacking*: there can be scepticism about the commitment of business interests to content of regulations and their enforcement.

(h) There are real and perceived doubts about the ability of professional or trade bodies to both represent the interests of their members and aspire to a public interest role. *Doubts about impartiality* are especially acute where the self-regulator is responsible for enforcement, or is involved in adjudicating disputes between consumers and traders.

(i) Inadequate self-regulation may act as a *barrier to adequate legislation*.

(j) As with legislation, if there is no commitment and resources for monitoring and enforcement, *effectiveness will be limited.*

## **A voluntary code in action: Code of Banking Practice**

The self-regulatory Code of Banking Practice is followed by banks and building societies in their dealings with customers. The code focuses on the following key commitments:

- acting fairly and reasonably
- giving information in plain language
- helping to choose a product suitable for the customer's needs
- correcting mistakes and handling complaints speedily
- treating financial difficulty and mortgage arrears sympathetically and positively.

There have been several editions, and there are regular reviews. The financial services industry and consumer and advice organisations are consulted on content. In an initiative outside the regular reviews, the code was recently updated to deal with concerns about keeping customers informed about interest rate changes.

Observance of the code is monitored by the Independent Review Body for the Banking and Mortgage Codes, which includes consumer and other 'outside interest' representatives. The Review Body has, until recently, employed only one member of staff for monitoring. In practice, monitoring relies heavily on asking banks and building societies to certify that they have systems in place for observing the code's provisions. Some reliance is placed on complaints to the Independent Review Body (though this is not really a complaints body and has a low profile) and press coverage of problems. But there is little measurement of what actually happens to consumers. The system relies on complaints-handling by the Banking Ombudsman.

We recently reported on how the code operates in connection with consumers in trouble with their accounts (*In the Bank's Bad Books*, National Consumer Council, 1997). In our recommendations we said:

'The Independent Review Body should be more proactive in reviewing the operation of the code. In addition to completing the annual statement of compliance by each institution, we would recommend building on the research carried out for this report, by carrying out a similar survey next year and in future years. We would also recommend other methods of establishing the effectiveness of the code, such as mystery shopping.'

We also recommended a system of sanctions for situations where the Review Body's monitoring shows non-compliance. At present, sanctions appear to be limited to a warning to the bank or building society concerned. We are glad to note that, very recently, some of these concerns have been accepted and proposals for more effective monitoring adopted.

## 4. Self-regulation in practice

In this chapter we review seven examples of self-regulation in practice in the UK – starting with trade association codes that have Office of Fair Trading approval, and going on to self-regulatory arrangements in the fields of insurance selling, financial services, advertising, solicitors, builders and health services professionals. We focus particularly on the limitations of trade and professional bodies' arrangements and the need for self-regulation to be rooted in a legal framework.

### **Example 1: trade association codes approved by the Office of Fair Trading**

Under section 124 of the Fair Trading Act, the Director General of Fair Trading has a duty to 'encourage' trade associations to draw up and adopt codes that will safeguard and promote the interests of consumers. Appendix 2 lists the codes that have been formally approved by the Director General under this provision. In recent years the effectiveness of codes of practice backed by the Office of Fair Trading (OFT) has been questioned by consumer organisations and by the OFT itself.

In 1996, for instance, Consumer Congress wrote to 38 trade associations responsible for overseeing 21 codes of practice approved by the OFT, asking for details about the operation of codes. With some honourable exceptions, the picture that emerged was one of inactivity and complacency by the very bodies – the trade associations – most likely to advocate self-regulation. Most reported few complaints and some said they had received no complaints at all. Only two out of 27 trade associations had conducted any sort of research into consumer awareness of, or attitudes towards, their codes. Independent lay involvement was rare and – with notable exceptions – there was little evidence that commitments were being fulfilled or sanctions enforced. Five associations did not even know when they had last discussed their code with consumer representatives, enforcement bodies or advice services.

In 1998, following a consultation to which both Consumer Congress and the National Consumer Council responded, the OFT published its own report, *Raising Standards of Consumer Care: progressing beyond codes of practice*. As the title implies, the OFT concluded that its policy of formal support for codes had not met expectations:

With notable exceptions, the overall regime of OFT-supported codes *does not command sufficient support* from all interested parties.

Trade associations have *difficulty in reconciling the roles* of protecting members' interests with regulating standards of service.

Consumer bodies and trading standards authorities commented on the *low visibility of codes* and a format which is too lengthy, variable and complicated to make a significant impact on most consumers.

Codes have *little influence on buying decisions*, so there is little incentive for firms to comply.

There is a risk of a '*lowest common denominator*' approach to setting standards.

Trade associations face difficult *disciplinary conflicts*, especially when expulsion is the main sanction.

The numbers of customers using *redress schemes* are 'disappointingly low'.

Some highly reputable traders prefer non-involvement with codes, because of the *risks to brand image*.

Trade associations generally *lack the resources* to raise the profile of codes and there are sometimes disputes or overlaps with other trade associations.

The OFT concluded that after twenty years' experience and development, the problems inherent in the operation of codes of practice meant that a different tack was now needed, especially in the key areas of publicity, standard-setting, enforcement and redress.

The government's Consumer Strategy accepted that some codes are little more than sales devices. Published in July 1999, it proposes to:

provide core principles for effective codes of practice, designed wherever possible to prevent problems happening in the first place;

encourage trade associations to tailor the principles to the specific circumstances of their industries or selling methods, ensure that members stick to them, and take effective action if they do not;

enable the OFT to approve codes which are effective in protecting consumer interests.

We welcome the role that is to be given to the OFT to promote the principles and provide a seal of approval for schemes, to help consumers identify businesses which adhere to codes. This will need serious commitment from the OFT if it is to deliver a system consumers can rely on.

### **Example 2: insurance selling**

The Association of British Insurers (ABI) Code of Selling of General Insurance sets out some requirements for selling insurance policies. For example: making it clear to the customer whether the seller is tied or is independent; explaining the main terms of the policy; and drawing attention to unusual or onerous policy restrictions. The National Consumer Council participates in the ABI Independent Code Monitoring Committee, which monitors the operation of the Code.

In 1998, in collaboration with the National Association of Citizens Advice Bureaux and Consumers' Association, we pressed for a range of improvements to:

- (a) the independence, resources and accountability of the Committee;
- (b) public awareness of the Code; and
- (c) sanctions and enforcement.

The ABI subsequently implemented some of these. For example, more independent representatives and consumer representatives have been appointed.

The ABI regime on insurance intermediaries has some effective features, for example:

Member insurers pay for an ongoing audit of independent intermediaries, to check and guide compliance with the Code. The audit involves a comprehensive questionnaire, risk assessment, compliance audits, advice on compliance, with links to a disciplinary process if advice has no effect.

It uses mystery shoppers to check compliance.

It supports a programme of training for consumer advice workers carried out by the staff of the Insurance Ombudsman Bureau.

But the operation of the Code also has a number of flaws:

Claims and complaints handling: the scheme does not enforce insurers' observance of the ABI statements of practice on claims, which set standards for matters which arise after the sale.

Competence: in other words, the knowledge, understanding and skills required for selling insurance or handling clients' money.

Lack of flexible and proportionate penalties for insurers, such as fines.

Monitoring: there is no third party audit for insurers which – given that independent intermediaries are subject to this – gives rise to a perception of unfair competition.

Status: the form of the Code's requirement for intermediaries to disclose their position as either tied agents or independent intermediaries gives a meaningless or, worse, misleading impression to consumers.

Redress: the Code in effect makes the insurer liable for an independent intermediary's failure to comply if the insurer has failed to use its best endeavours to achieve the intermediary's compliance. Otherwise, the Insurance Ombudsman has no authority to deal with a complaint against an intermediary who is not in the scheme.

In November 1998 the ABI and a number of other insurance industry bodies consulted on a new self-regulatory set-up for the insurance industry, to be known as the General Insurance Standards Council (GISC). The body is to cover advice on, and sales of, general insurance and re-insurance in the UK.

In our response, *General Insurance Self-regulation* (National Consumer Council, January 1999) we outlined our concerns over the ABI Code of Practice and concluded that the new scheme seemed to be looking for the lowest common denominator rather than striving to meet the needs of consumers. There are many aspects of the new regime which we support. These include requirements related to financial probity, requirement for all intermediaries to belong to the voluntary regime of the Financial Services Ombudsman and provisions relating to competence and training. The new proposals, however, do not address our concern that the scheme proposes only to regulate *selling*, not the observance of the statements of practice on *handling claims*.

Our chief concern lies with the governance proposals. Despite a declared intention that '... the independence of the new regime will be a key factor in establishing its credibility', there were to be no public interest or consumer representatives on the board of the GISC. Since the original proposal, the GISC has decided there should be two public interest representatives, out of a total of 17 board members. While the proposals also involve an external scrutiny committee, this is not an adequate substitute for a majority of non-industry board members.

### **Example 3: financial services**

One of the most comprehensive, and complex, examples of a statutory/self-regulatory inter-relationship was established in 1986 for the financial services sector.

The white paper that preceded the Financial Services Act 1986 said that the law should provide a clearly understood set of general rules, but that 'self-regulation has a continuing and crucial contribution to make. It means commitment by practitioners to the maintenance of high standards as a matter of integrity and principle, not because they are imposed from outside.'

That Act did not prove to be a success. The arrangements that emerged – a private Securities and Investments Board recognised under statutory authority, in turn overseeing a collection of self-regulatory organisations – did not seem to satisfy anyone. The self-regulatory organisations



were criticised for ineffectiveness, while many financial service businesses felt that the approach was not genuinely self-regulatory, with a tendency towards bureaucracy and heavy-handed enforcement.

The present government's proposals to repeal the 1986 Act and to create a Financial Services Authority are now taking shape through the draft Financial Services and Markets Bill, published in July 1998. The wide-ranging scope of this legislation, and the grant of strong legal powers to a statutory body, are seen as a rejection of self-regulation. It is certainly a rejection of the arrangements set up under the 1986 Act and a shift along the spectrum from self-regulation to regulation.

But it would be a mistake to overlook the self-regulatory elements that will stay in place. For example:

The Financial Services Authority (FSA) includes some board members drawn from the industry.

The legislative and regulatory processes involve extensive consultation with the industry.

The FSA has established a Practitioner Panel through which practitioners will continue to have a good deal of influence.

The Financial Services Ombudsman will have a 'voluntary' jurisdiction to include activities that do not fall within the compulsory jurisdiction.

Conduct of business in banking, general insurance and mortgages will – at least for the time being – be left to self-regulation.

#### **Example 4: advertising**

The self-regulatory arrangements for the greater part of the print advertising industry are widely held to be reasonably successful and were strongly supported by government in its consumer

white paper, *modern markets: confident consumers*. They operate under conditions that favour success, including a background threat of legislation and the availability of special sanctions. There are also complex institutional arrangements designed to remove the operation of the Advertising Standards Authority (ASA) Council from direct industry control.

Although the Committee of Advertising Practice (CAP) co-ordinates the efforts of the 21 sponsoring trade and professional associations to promote compliance, it is the independent ASA that has responsibility for interpreting and administering the British Codes of Advertising and Sales Promotion. And it is the ASA's independence that is seen as key to its acceptance as a robust regulator.

Eight of the ASA's twelve members are lay and the remainder are independent individuals, not delegates, who bring useful inside experience of advertising. The ASA monitors compliance with the Codes and investigates over 12,000 complaints a year. Important features include the ASA's monitoring and research programme, the publication of monthly Case Reports and an Annual Report, and the prominent publicity given to the scheme. The effect of adverse publicity and the sanctions of withdrawal of trading privileges, and ultimately, the denial of media space to offenders are highly important. In addition, a copy advice service is offered to advertisers, agencies and the media by the joint secretariat of the CAP and ASA, on behalf of the CAP.

The Codes themselves are sophisticated documents, elaborating the basic principles that advertising should be legal, decent, honest and truthful. In some areas their flexible and informal approach certainly goes well beyond what could easily be required by law. There are specialist sections of the Codes that deal, for example, with health and beauty claims, vitamins, slimming, distance selling, financial services, children, alcoholic drinks, environmental claims, betting and gaming, and cigarette advertising. The use of specialist sections allows the Codes to adapt to market changes as they develop, and Codes are revised and updated regularly. Notably, however, the Codes are drawn up by the CAP without any outside representatives sitting on the committee, although extensive consultation is undertaken.

The main criticisms of advertising self-regulation relate to the length of time investigation and adjudication can take, and the consequent lack of effect this has as a deterrent. The prospect of an adverse finding, buried in a case report many months after the end of the advertising campaign, is unlikely to inhibit some borderline advertising claims or even blatant offenders, although the

ASA can point to cases where advertisers have fought strongly to avoid a negative adjudication. The ASA challenges the view that the process is over-lengthy, pointing out the quasi judicial function it undertakes and the complexity of some adjudications, for which experts may have to be consulted. It would be helpful if monthly case reports gave some idea of when the complaint was made in order to judge how long on average it takes to deal with a case. The system also has a power to require poster advertisements to be pre-vetted by the CAP copy advice service when an advertiser has broken the rules on matters of decency or social responsibility.

#### **Health claims: a case for firmer regulation?**

In 1999 the Health Committee (a Select Committee of the House of Commons) took evidence on the regulation of private and independent health care, including its advertising.

We flagged up a concern that cases about misleading claims for clinics and health products appear regularly in the Advertising Standards Authority (ASA) bulletin and that firmer regulation may be needed in an area such as health, where consumers are highly vulnerable.

The ASA gave evidence to the Committee, as did an individual who had concerns about claims made by private clinics. He pointed out that clinics which had had adverse ASA reports against them, requiring them to change their copy, often continued to use the same advertisements apparently without any effective sanction.

Even the use of 'ad alerts' (where the CAP tells a magazine not to accept advertisements in future) did not appear to have had any effect in a number of cases. The ASA regarded this as an aberration and quoted figures to show very high compliance. In health claims, they said, they have difficulty with terms such as 'fully qualified' and 'very experienced' and that they only regulate *advertising*, not what actually happens inside a clinic, and we accept that there is a vacuum in this area (National Consumer Council, *Self-regulation of Professionals in Health Care*, June 1999). Regulation of advertising cannot regulate the provision of goods or services which is itself not subject to any legal or other control.

Since 1988, there has been a statutory backup to the self-regulation provided by the ASA and other bodies such as the Direct Marketing Authority. The EC Directive on Misleading Advertising was implemented in the UK by the Control of Misleading Advertisements Regulations 1988. The Directive itself was much changed during negotiations, to accommodate the UK self-regulatory system. The Department of Trade and Industry made it explicit at the

time that the Regulations were intended to act as a 'long-stop' to 'strengthen' the self-regulatory system.

Under the Regulations, the Director General of Fair Trading is under a duty to consider complaints that an advertisement is misleading. If necessary, he is empowered to seek an injunction or interdict. But he has a discretion before considering any complaint to require the complainant to show:

that the 'established means of dealing with such complaints' ... have had a 'reasonable opportunity' to deal with the complaint; and

that 'those means have not dealt with the complaint adequately'.

The 1988 Regulations do *not* specify or prescribe the ASA as an 'established means' but (consistent with the wording of the Directive) they do require the Director General to have regard to 'the desirability of encouraging the control, by self-regulatory bodies, of

### **Backup when self-regulation fails**

In January 1999 the Advertising Standards Authority 'abandoned' its attempts to enforce its self-regulatory Codes against a company it claims sent more than five million unsolicited faxes advertising products from Viagra to World Cup football tickets. The company has been referred to the Office of Fair Trading – only the tenth time in eleven years the step has been taken. The Director General of Fair Trading secured a high court injunction to prevent the company from publishing the same, or similar, advertisements.

In practice, the Regulations have indeed worked as a long-stop, with the ASA continuing to handle the bulk of complaints and the OFT intervening in a very small number of intractable cases. The health claims cases show, however, that some advertisements may slip through the net and continue to appear, even after requests to change the advertisement's copy. In such cases, it appears there has been insufficient monitoring of the continuing advertisements to alert either the ASA or the OFT that further action needs to be taken.

We are strongly in favour of the kind of statutory underpinning that applies in the advertising sector, but consider that the ASA and OFT need to be much more open about when they think it appropriate to invoke the statutory provisions. Advertisers who flout ASA adjudication would then know that they risk further action. As Mr Justice Hoffman said, in the first case to be referred from the ASA to the OFT and which resulted in an injunction against a company advertising misleading slimming products (*DGFT v Tobyward Ltd* [1989] 2 All ER 266) :

*'I think that advertisers would be more inclined to accept the rulings of their self-regulatory bodies if it were generally known that, in cases in which their procedures had been exhausted and the advertiser was still publishing an advertisement which appeared to the court to be prima facie misleading, an injunction would ordinarily be granted.'*

### **Example 5: solicitors**

The solicitors' trade association, the Law Society, also regulates the profession, using devolved powers from the Lord Chancellor under the Solicitors' Act. Solicitors are subject to over 800 pages of 'practice rules', approved by the Council of the Law Society which is elected by the profession and has no lay members. The Law Society has an arm's-length agency, the Office for the Supervision of Solicitors (OSS), that deals with complaints by clients amounting to inadequate professional service and minor misconduct. More serious misconduct is dealt with separately by the Solicitors' Disciplinary Tribunal.

For poor service or minor misconduct, the OSS can: award compensation up to £1,000 for poor service (soon to rise to £5,000); order a solicitor to waive or reduce a bill; or order a solicitor to correct a mistake and pay for the costs of doing so. It can also intervene in a solicitor's practice where it suspects financial irregularities. The OSS maintains a fund to compensate clients who are victims of dishonest solicitors. Loss arising from negligence is handled through the Solicitors Indemnity Fund.

The OSS has learned from the criticisms of its predecessor (the Solicitors' Complaints Bureau) and consults widely. Its complaints scheme is well publicised and it has clear principles, standards and targets. It conducts customer satisfaction surveys and publishes the results, and reports on targets. Its Compliance and Supervision Committee has a lawyer majority. The Client Relations Sub-committee has a lay chair and lay membership.

But it is arguable how much influence the lay members have on regulation and complaints-handling policy: it is certainly not a controlling one, which lies with the Law Society's Council. The blurred boundaries between low level negligence and poor service on the one hand, and more serious negligence and dishonesty on the other, confuse clients. Given that there are some 75,000 practising solicitors, compliance centres largely on reacting to those seen to be causing problems to clients, other solicitors or other professionals, although the more proactive measures include a phone line for reporting misconduct or dishonesty.

The OSS is undergoing a review of its complaints-handling function. It aims to turn itself into a body that reviews how firms deal with complaints, rather than dealing with the complaints itself. This will require the OSS and the Law Society Council to agree and distribute a detailed code of practice and a package of sanctions for those who breach the code.

However, the solicitors complaints scheme has never commanded public confidence. In the past, its main problems were its closeness to the Law Society, its legalistic procedures that appeared to favour the solicitor, and long delays. Today's scheme, the OSS, has made its case-handling procedures more client-friendly, but continuing unacceptable delays caused by the sheer volume of complaints, and questions about its independence from the Law Society, remain. Recently the dividing line between the two bodies was further blurred when the Secretary General of the Law Society took over, for the short term, the management of the OSS because of internal crisis.

The scheme is accountable to the Lord Chancellor through the Legal Services Ombudsman, who keeps it under review and reports annually on its operation. As a result of continuing criticisms, the Access to Justice Act 1999 gives the Lord Chancellor powers to establish a new office which will be able to intervene effectively to improve complaints-handling by the legal professional bodies. So looming in the background, if the OSS fails to deal with complaints adequately and in good time, will be the creation of an independent body.

### **Example 6: builders**

As we reported in our review of the building trade, *Controlling the Cowboys*, consumers searching for a builder are encouraged to look for membership of a trade association as a measure of security. But the sheer number and diversity of trade associations in the field is a major problem – a scan of the British Directory of Associations shows no fewer than seventy trade or professional associations in the building and allied industries. Undoubtedly many are reputable

bodies (though even they operate with a variety of different objectives, rules and membership requirements). Equally, there are less reputable outfits whose objective is simply to make money from selling membership in exchange for a marketing logo. How can consumers be expected to find their way through the maze and identify a reliable trade association?

In an earlier study of small-scale builders in Bristol (Bristol University and the Rowntree Foundation, *Improving the Efficiency of the Housing Repairs and Maintenance Industry*, 1995), trade associations were criticised by builders themselves for their lack of rigorous membership criteria. Organisations that did not carry out inspections of work or obtain customer references, concluded the report, could give no guarantee of quality against measured standards. Membership was as open to the cowboy element as to more competent firms. The specialist trade bodies that regulate heating and electrical work were felt to be more effective than other trade bodies in vetting and keeping members up to date on technical developments and regulation changes. And some of these, such as CORGI (for domestic gas installation), operate a compulsory registration scheme, required by statute.

In 1998, the Department of the Environment, Transport and the Regions set up a 'cowboy builders working party'. Its report (August 1999) builds on some of the findings of our report, *Controlling the Cowboys*, and proposes an external accreditation scheme for individual construction businesses and trade associations. It also suggests a publicised national list of accredited builders, backed by an insurance-backed warranty and a complaints scheme. Like any voluntary scheme it will depend on proper vetting, monitoring and sanctions with independent supervision to command confidence.

Consumers are particularly in need of adequate protection when they buy newly built houses, and especially so when they buy from the original contracting purchaser. The protection they get from the law in this case is far less comprehensive than the legal protection given to buyers of ordinary goods. (For more details, see *Controlling the Cowboys*, National Consumer Council, 1996.)

### **Example 7: health service professionals**

The regulatory bodies for health professionals, including GPs, nurses, midwives, chiropractors, dentists and opticians, are set up under separate Acts of parliament.

Each statutory body has a council made up of representatives from the profession and educational bodies, from other professional bodies, and members appointed by the body to which the council is accountable (such as the Department of Health).

The councils vary in their organisational structure, but most have sections dealing with registration, education and training, and professional ethics and discipline. The public registers list the names of members, place and date of qualification, and address, but do not give information about previous actions taken against a professional.

We recently published a paper examining self-regulatory systems in the health sector (*Self-regulation of Professionals in Health Care*, National Consumer Council, June 1999). Among the problems we identified are:

The primary aim of professional regulation is to protect the public, but it has other, contradictory, functions. It also limits access to professions and protects and promotes the profession's own interests, so that there is an *in-built tension between the public interest and professional protectionism*.

There is *no over-arching body* to monitor and evaluate the extent to which the individual forms of professional self-regulation suitably serve the needs of patients. This is particularly relevant in the context of multi-disciplinary care.

People are poorly protected when using *private-sector services* (which may be financed by public funds). For instance, doctors do not have to have specialist training to practise a speciality, the professions allied to medicine do not have to be state-registered, and any qualified medical practitioner can set up a cosmetic surgery clinic and advertise for patients.

*Unregistered professionals* can be used in NHS services, for instance in general practice, through nursing or locum agencies.

Consumers do not understand which *health titles* are protected and which aren't – for instance, the use of 'nurse', 'physiotherapist', or 'psychologist'.



There is *no clarity about what it means to be 'on the register'* – with variations between bodies in the extent of the information they include about extra qualifications, whether the person is currently professionally active or not, re-validation or re-certification, and any previous actions taken against the practitioner.

There is *lack of openness* in the proceedings of the bodies at different stages – for instance, in the criteria used for screening initial complaints, the reasons for rejecting complaints, and information about the nature of complaints and their outcomes.

The extent of *lay and consumer participation varies* on councils and committees, and in the local audit and other processes that are an integral part of health self-regulation.

## 5. Assessing self-regulatory arrangements: the key factors

'Black-letter' law enforcement cannot by itself promote good business standards or eliminate unacceptable practices. And as we have seen, self-regulation by itself can seldom provide completely effective consumer protection. Weighing up the respective merits of legislation and self-regulation is often a matter of 'horses for courses'. The challenge is to decide which horses for which courses.

There are many stopping-off points along the broad spectrum between completely unilateral self-regulation and precise, specific statutory controls. Equally, there can be strong self-regulation and weak legislation (for instance, where the law depends on individual consumer initiative for its enforcement). It is the nature of the problem, the policy objectives and the political/economic background that will largely determine the most appropriate approach.

The National Consumer Council has had extensive experience over many years of observing, assessing, commenting on and – to some extent – participating in self-regulatory arrangements of various kinds. This experience, and the policy and practice reviewed in this paper, have led us to draw conclusions about the basic essentials for effective self-regulation.

In this chapter we identify four central issues of principle (1 to 4 below) plus four practical considerations (5 to 8 below). Together they make up the core guidelines (summarised in the chapter 6 checklist) that will inform the National Consumer Council's assessment of any self-regulatory arrangement.

### **The National Consumer Council's approach to policy and practice**

1. A self-regulatory scheme must always have clear **policy objectives**.
2. Self-regulation should not inhibit the scope for **competition** to deliver benefits for consumers.
3. A strong **independent element** must be involved in the scheme's design and have a controlling influence on its governance.
4. A **dedicated institutional structure** must be set up, separate from the existing trade and professional organisations.

5. A **pragmatic** approach may be inevitable.
6. There should be a **presumption of scepticism** towards self-regulation organised on a collective basis.
7. Effective self-regulation is usually best stimulated by a **credible threat of statutory intervention**.
8. Self-regulation works best within some form of **legal framework**.

### **Guideline 1: policy objectives are the starting point**

The first step for any form of regulation must be to frame its policy objectives (as distinct from the method for achieving them). In other words, there has to be clarity about the need and rationale for intervention in the market, based on the ground covered by the list set out in chapter 1 (see page 2).

Eventually there may have to be trade-offs between what might be achieved by legislation and what might be achieved by self-regulation, but these should follow *after* the expression of the optimum policy objectives.

It is increasingly common to use cost benefit analyses, compliance cost assessments and regulatory impact assessments to assess statutory interventions. The National Consumer Council does not itself carry out any sort of *economic* appraisal of self-regulatory schemes. Quite apart from the resources this would involve, we feel it is an inappropriate and limiting approach, notably because of the difficulty of measuring critical 'non-efficiency' values like accountability and fairness.

### **Guideline 2: self-regulation should not inhibit competition**

Self-regulation must work, as far as possible, with the grain of the market. This could mean encouraging worthwhile initiatives by individual businesses, particularly where these can be formalised into a measurable, accountable consumer charter.

A 'core standard for the better business' – along the lines of the discussion draft produced by the Office of Fair Trading for its *Raising Standards* conference in September 1998 – may be another way for self-regulatory initiatives to be harnessed to a lively competitive process. The internet, and other improved means of delivering information to consumers, are likely to contribute to publicising worthwhile initiatives by individual businesses.

On the other hand, where self-regulation involves collective arrangements between businesses, it is essential to consider the potentially damaging effects on competition (see guidelines 6 and 8 below).

### **Guideline 3: there must be strong independent input**

#### **Advance consultation**

Self-regulation is unlikely to be effective unless there has been a genuine process of consultation and involvement beforehand. This will usually extend to all the stake-holders identified by those promoting a scheme – for example, government, regulatory and representative bodies.

Consumer organisations will usually expect to be informed and consulted too, although they need to remain alert to the danger of being used to bring legitimacy to a weak arrangement. This proviso is even more critical where it is proposed that consumer organisations get directly involved, or nominate representatives. It is of particular concern where one or two representatives, without wide-ranging expertise, access to research resources or payment, are brought in to make it look as though there is a real opportunity for consumers to influence the operation of the scheme.

#### **Independent input to the scheme's operation**

If a business or industry seriously intends to show that its self-regulatory scheme is a viable alternative to statutory regulation, it has to address the question of independent development and operation.

For credibility and legitimacy, there are three areas where independent input is critical:

the making of the rules;

the overseeing of monitoring and enforcement, including the imposition of sanctions;  
and

the overseeing of any redress mechanism.

Some existing schemes incorporate these three areas into a single system. Others divide them up between different bodies (as we saw in chapter 4).

With some exceptions, a trade or professional organisation cannot be expected to carry responsibility for running a self-regulatory scheme. Its first job is to represent its members' interests. At best, trade bodies have persuasive influence, rather than real power, over their membership and are generally in a weak position to secure commitment to a code's provisions or to enforce them effectively. However committed, they will be caught between alienating their own membership yet still generating public scepticism about their impartiality. There appear to be real difficulties for most trade associations, too, in securing the resources and commitment needed for adequate monitoring and publicity.

It is striking that the more successful self-regulatory schemes – the advertising, ombudsmen and direct marketing schemes, for instance – are all enforced through *dedicated organisational structures* outside the industry itself (though the financial services experience with self-regulatory organisations suggests that a separate structure is not enough on its own).

It also seems to be important that the *controlling influence* – notably the membership of the governing body – should be *genuinely independent*, coming from outside the industry that is the subject of regulation. This does not necessarily mean a majority of consumer representatives: it might include professionals, academics, representatives of other interests or industries, or statutory regulators.

However, we recognise that independent operation is not always achievable in practice. We may sometimes have to accept schemes that do not meet the ideal. In particular, we recognise that self-regulatory systems themselves may evolve along the spectrum we outlined in chapter 2. Where this is the case, we are likely to take a different view about what is acceptable, depending

on which of the three functions – rule-making, monitoring and enforcement, and redress – is in question.

As with the court process, there is little doubt that any *redress* mechanism should be free from pressures from the trade or professional body to deliver decisions which suit its purpose or appear to favour members. So the running of the redress system should *always* be separated from the rest of the scheme, and with lay members in a majority.

Similarly, the body for *code monitoring and enforcement* – a role akin to a policing or trading standards function – should usually have a majority of independent lay members. Trade bodies find it very difficult to impose sanctions on their own members and may also be tempted to stint on the effort needed to monitor compliance with a code.

In practice, it is in *drawing up the rules* that a lay majority is most often missing. Where the rules are part of a voluntary scheme that is attempting to raise standards above those required by the law, there is probably no place for imposing the views of outsiders who will not be involved in delivering the improvements. However, this only applies where statute has already fixed the basic standards.

Making the rules is the area that professional bodies, and those with special expertise, guard most jealously. There is a feeling that outsiders do not have the knowledge needed to judge what is appropriate. We are not persuaded that this is the case, or that insiders can always distinguish between what they think is in consumers' interests and what is their preferred way of carrying on.

If there is not to be a majority of lay people on the body that makes the rules, there must be some regular outside scrutiny:

from the competition authority, to ensure that the self-regulatory body does not set entry requirements that are too high;

from government, to impose statutory rules where the profession or industry is not prepared to act in the public interest; and

perhaps from the Office of Fair Trading, to make sure that the balance of interests is fairly resolved in deciding what the rules should be.

All this does not mean that involvement by the trade or profession should be excluded altogether. A major benefit of successful schemes has been the input from those who really understand what can, and does, happen in the field and have a well-developed sense of acceptable and unacceptable practices. This contribution is important at all stages – the design and refinement of the scheme, ensuring compliance, investigating complaints and ensuring adequate redress. The challenge in each case is to achieve the right balance between insiders and outsiders.

#### **Trade associations: an insider's view**

'The two basic functions of trade associations are representation and the provision of information to

Most trade associations do not attempt to influence the conduct of their members ... They can have only limited power over their members and if they attempt to exercise that power they may suffer a loss of membership or even risk action under the restrictive trade practices legislation ...

An industry is likely to seek to regulate behaviour of market participants where by so doing it will improve the image of the industry, increase sales and perhaps fend off statutory regulation which invariably is seen as being worse than self-regulation, although this is an assumption which is open to challenge.

The industries where self-regulation is most appropriate are those which deal directly with the public and where the product is difficult to evaluate. Problems occur where the public have little knowledge of what they are buying. This applies particularly to some financial services, building work and car repairs ...

The problems for trade associations being regulators are basically those of ensuring that everyone in the market is covered, how any regulations are to be enforced and also possibly ensuring that restrictive trade practices legislation is not used against them. All such arrangements are potentially unstable and perhaps are held together predominantly by the fear of more onerous statutory regulation.'

**Mark Boleat, Trade Association Strategy and Management**

#### **Guideline 4: a dedicated institutional structure**

If trade and professional associations are not the appropriate bodies to run self-regulation – as we believe they are not – it will usually be necessary to set up separate organisational arrangements specifically for the purpose.

The body set up must have proper resources to carry out its task. The features it should have to be considered credible are set out in a checklist which forms chapter 6 of this report.

Clearly some self-regulatory schemes, such as those covered under the categories of official codes and guidance, and legal codes, are unlikely to have an independent structure.

#### **Guideline 5: a pragmatic approach**

On some occasions – for example, where there is no realistic prospect of legislation – self-regulation on its own may be the only option.

International electronic commerce is an obvious example. Here, there is almost no prospect of meaningful regulation being agreed and enforced globally. If consumers are not to be entirely abandoned to a ‘look after yourself’ free-for-all, self-regulatory options simply have to be considered .

There may be occasions, too, where self-regulation will probably be as good as, or even better than, anything that could be achieved by statute. This includes sectors where traders are happy to agree to abide by higher standards than those required by legislation or where there is likely to be greater compliance as a result of direct trader participation. A self-regulatory scheme may also be suitable for dealing with detailed technical or single-sector issues, or for refining vague and imprecise legal concepts (like ‘fairness’, ‘reasonableness’ and the like), or to act as a test-bed for legal rules.



## **Guideline 6: a sceptical approach to collective self-regulation**

Self-regulation that brings businesses together into a collective activity clearly has the potential for anti-competitive effects and other limitations. This means always treating such arrangements with a degree of scepticism.

Those who propose self-regulation must show there is some genuine consumer advantage to be gained. Why is this self-regulatory arrangement better than legislation for the particular purpose? If the industry says it will observe self-imposed rules, why not the same rules written into legislation? Where consumer detriment is acknowledged, why has the industry not put its house in order already? Is it really sensible to 'try self-regulation first'? Will self-imposed rules really go further, be more positively observed and be more effectively enforced than legal rules? If self-regulation is claimed to be cheaper and more flexible, is there a real commitment to monitoring and enforcement?

In essence, this guideline is to make sure we ask questions about *motivation* which, among other things, may be:

***Cosmetic:*** to improve image or enhance status.

***Beneficial:*** to raise standards, to refine or improve legislation, or to provide cheaper/quicker redress.

***Detrimental:*** to forestall necessary legislation or regulation; to restrict competition.

## **Guideline 7: backed by a credible threat of legislation**

The fear of unwelcome statutory regulation has been the driving force behind many – perhaps most – self-regulatory schemes. The more explicit and focused the threat, the more effort is likely to be put into self-regulation, though even a general anxiety about possible intervention (as with professional services) will sometimes act as a spur.

### **When legislation hovers in the wings**

The Jack Committee on Banking Services (February 1989) called for improvements in standards of banking practice, and expressed a predisposition for non-statutory self-regulation. The Committee report included an illustrative Code and expressed the 'earnest hope and expectation' that the banks would, by introducing such a Code, respond fully and convincingly to the need for a substantial improvement in standards. The report also proposed a 'fallback measure' – for government to introduce a statutory code – if the bank's response was inadequate or non-existent.

The government of the day decided against statutory provision immediately, but the threat of legislative backing succeeded in putting pressure on the industry. The banks and building societies, through their associations, responded in March 1992 by introducing the Banking Code, backed by an independent Review Committee. Conscious that legislation remains a possibility, the industry has substantially improved this self-regulatory arrangement over the years (see chapter 3, page 25).

A similar strategy is being pursued by the present government in relation to mortgages. Here, the threat is backed by reserve powers in the Financial Services and Markets Bill which can be activated by ministers through secondary legislation. The mortgage industry is clearly trying to demonstrate that the Mortgage Code is effective, although many believe that statutory intervention is inevitable (not least because self-regulation cannot control all intermediaries and some lenders on the fringes of the market).

### **Guideline 8: self-regulation works best within a legal framework**

Self-regulation and legal regulation are not black-and-white opposites. It is widely accepted that the right balance has to be found between the two. Self-regulation, at its best, can be seen as a co-operation between the regulator, regulated and those in whose interests regulation is made. But for self-regulation to work effectively, there may be a need for a concept of co-regulation which is underpinned by legal regulation.

## Codes and the law: Australian 'co-regulation'

In 1998 the Australian government issued a *Policy Framework on Codes of Conduct*. This said that where self-regulation fails, legislative options would be pursued to provide the means for industry to self-regulate effectively. 'Co-regulation' was described as a process where *industry* develops and administers a code and the *government* provides the ability to enforce it through legislative backing.

The main roles for the back-up legislation would be to:

- delegate to industry the power to regulate and enforce the code;
- enforce undertakings to comply with the code;
- prescribe the code, but only apply it to those who choose to be bound;
- set out required standards, but provide for an approved code to modify or elaborate them;
- provide a reserve power to make a voluntary code compulsory;
- require the industry to have a code and, in its absence, impose a code; or
- prescribe a mandatory code.

The best UK and overseas examples of self-regulation at work seem to be those where there is a legislative framework within which 'private' initiatives can take place. It is helpful to have a public institutional structure in place (such as the Office of Fair Trading) charged with monitoring self-regulatory initiatives, and we welcome the role to be given to the OFT in the consumer strategy. Failures and/or breaches of self-regulation may have to be corrected by effective public remedies.

So the recent UK trend towards self-regulation within a statutory framework has particular attractions. A code with a self-regulatory element, and which is recognised by statute, can bring positive advantages for consumers.

It is important that the status of the code is made clear. A self-regulatory code can be especially useful where it is admissible *in evidence* to illustrate a general legal rule or duty, and where the statute makes it clear that the general rule is *binding on all traders*, irrespective of trade association membership .

The National Consumer Council has long seen Part III of the Fair Trading Act as a potential tool for controlling business practices that are unfair but not illegal. We have already said that self-regulation can deal better than the law with questions of complex subjective judgement, such as 'fairness'. If Part III could be used to give a legal framework to self-regulatory code rules dealing with 'unfair' behaviour, the problems of incomplete coverage and lack of sanctions could be addressed.

The government's Consumer Strategy proposes changes to Part III, which seem to fall short of including 'unfair but not illegal' practices within its scope. We consider it essential if the Act is to be used to underpin self-regulatory schemes that there is in effect a legal duty 'not to trade *a set of principles* the court could use in deciding whether business conduct is unfair.

In addition, we have suggested that in problem areas – like the building trade and 'green' claims for products – the Office of Fair Trading should take the lead in developing codes that would apply to the *whole* of a sector. Breach of the provisions in a code relating to fairness could be used as evidence of unfair practices for the purposes of Part III, without actually being illegal (in much the same way as the codes of practice relating to health and safety are already used under employment law).

The importance of Office of Fair Trading involvement in codes of practice cannot be overstated. Its scrutiny is essential to make sure that all interested parties have an opportunity to represent their case and that the major players in an industry do not use the code anti-competitively to prevent entry at a lower level.

## 6. The credible self-regulatory scheme: a checklist

1. The scheme must be able to command **public confidence**.
2. There must be strong **external consultation and involvement** with all relevant stakeholders in the design and operation of the scheme.
3. As far as practicable, the operation and control of the scheme should be **separate** from the institutions of the industry.
4. Consumer, public interest and other **independent representatives must be fully represented** (if possible, up to 75 per cent or more) on the governing bodies of self-regulatory schemes.
5. The scheme must be based on **clear and intelligible statements of principle** and **measurable standards** – usually in a Code – which address **real consumer concerns**. The objectives must be rooted in the reasons for intervention (outlined in chapter 1.)
6. The rules should **identify the intended outcomes**.
7. There must be clear, accessible and **well-publicised complaints procedures** where breach of the code is alleged.
8. There must be adequate, meaningful and commercially significant **sanctions** for non-observance.
9. **Compliance must be monitored** (for example through complaints, research and compliance letters from chief executives).
10. **Performance indicators** must be developed, implemented and published to measure the scheme's effectiveness.
11. There must be a degree of **public accountability**, such as an Annual Report.
12. The scheme must be **well publicised**, with maximum education and information directed at consumers and traders.

**13.** The scheme must have **adequate resources** and be funded in such a way that the objectives are not compromised.

**14. Independence** is vital in any redress scheme which includes the resolution of disputes between traders and consumers.

**15.** The scheme must be regularly reviewed and **updated** in the light of changing circumstances and expectations.

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# Appendix 2: list of self-regulatory schemes affecting consumers

**This list is not comprehensive. It merely gives an idea of the range of areas covered.**

## **Unilateral schemes**

British Complementary Medicines Association

Council for Complementary and Alternative Medicine

National Federation of Builders Code of Practice

International Chamber of Commerce - Guidelines on Advertising and Marketing on the Internet (adopted by Board on 2 April 1998)

## **Negotiated schemes**

Association of British Insurers General Code of Practice

Association of British Insurers Code of Practice for Intermediaries

Association of Energy Suppliers' Code of Practice

Association of Plumbing and Heating Contractors

Banking Code

British Codes of Advertising Standards and Sales Promotion

Funeral Ombudsman Scheme Ombudsman

Green Claims Code of Practice

Independent Committee for the Supervision of Standards of Telephone Information Systems (ICSTIS)

Insurance Ombudsman Scheme

Local Authority Schemes - Warwickshire, Sutton, Devon

Mortgage Code

Ombudsman for Estate Agents

Personal Insurance Arbitration Service

Pre-paid Funerals Code of Practice

## **Trade Association Codes supported by the OFT**

### **Credit**

The Consumer Credit Association of the United Kingdom

The Consumer Credit Trade Association

Credit Services Association

Finance and Leasing Association

London Personal Finance Association Ltd

The National Consumer Credit Federation

### **Double glazing**

Glass and Glazing Federation

### **Domestic electrical appliance servicing**

The Association of Manufacturers of Domestic Electrical Appliances

### **Selling and servicing of electrical and electronic appliances**

The Radio, Electrical and Television Retailers' Association (RETRA) Ltd

### **Extended warranties on electrical goods**

British Retail Consortium

### **Domestic laundry and cleaning services**

Textile Services Association Ltd

### **Residential estate agents**

Incorporated Society of Valuers and Auctioneers

National Association of Estate Agents

Royal Institution of Chartered Surveyors

(enforced through the Ombudsman for Estate Agents)

### **Footwear**

The British Footwear Association

The Independent Footwear Retailers' Association

Instock Footwear Suppliers Association Ltd

### **Footwear repairs**

The Society of Master Shoe Repairers

Holiday caravans (letting code, and selling and siting code)

Holiday caravans (letting code, and selling and siting code)

British Holiday and Home Parks Association Ltd

National Caravan Council

**Introduction agencies**

Association of British Introduction Agencies

**Direct marketing**

Direct Marketing Association Code of Practice (and related schemes enforced through the Direct Marketing Authority)

**Mail order trading**

The Mail Order Traders' Association

**Direct selling**

The Direct Selling Association Ltd

**Mechanical breakdown insurance**

Society of Motor Manufacturers and Traders Ltd

**Motorcycles**

Motor Cycle Industry Association

**Motor industry**

Retail Motor Industry Federation Ltd

Scottish Motor Trade Association Ltd

Society of Motor Manufacturers and Traders Ltd

Tyre and fast-fit industry

The National Tyre Distributors Association

Vehicle body repairs

**Vehicle Builders and Repairers Association Ltd**

Vehicle rental and leasing

British Vehicle Rental and Leasing Association

**Tickets (resale for all forms of entertainment)**

The Society of Ticket Agents and Retailers

**Tour operators and Travel Agents**

Association of British Travel Agents Ltd

**Photography**

The British Imaging and Photographic Association  
The British Institute of Professional Photography  
The British Photographic and Imaging Association  
Master Photographers Association  
The National Pharmaceutical Association  
Photo Marketing Association International (UK) Ltd  
Professional Photographic Laboratories Association

### **Recognised schemes**

#### **Legislation giving power to create codes or rules**

Auditors Act 1997  
Data Protection Act 1998  
Dentists Act 1984  
Financial Services Act 1986  
Insurance Brokers Registration Act 1977  
Solicitors Acts (various dates)

#### **Codes or rules made by chartered bodies (responsible to Privy Council)**

Institute of Chartered Accountants  
Royal Institution of Chartered Surveyors

#### **Codes or rules made under licencing regimes**

Codes of practice for sale of energy contracts  
ITC Code of Advertising Standards and Practice  
ITC Code of Programme Sponsorship  
OFGEM  
Radio Authority Advertising and Sponsorship Code

#### **Health**

Medical Act 1983  
Nurses, Midwives and Health Visitors Act 1979  
Osteopaths Act 1993

#### **Legal Codes**

Code of Practice for Packers  
Code of Practice on Misleading Price Indications

Financial Services and Markets Bill

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