Financial Conduct Authority

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Changes to Supervision Model

Lead regulator: FCA

Date of assessment: October 2016

Commencement date: September 2015

Origin: Domestic

Does this include implementation of a Cutting Red Tape review? No

Which areas of the UK will be affected? All regulated firms

Brief outline of proposed new or amended regulatory activity

Due to a perception that our supervision model was overly prescriptive, we have made a number of key changes to the model. This leads to cost savings for firms with no additional costs imposed.

1. **Creating more flexibility in our approach to supervising fixed portfolio firms:** In line with the sector risk appetites supervisors have increased discretion to determine the appropriate level of supervision for individual firms. Changes were made to the minimum Pillar I requirements that supervisors are expected to adhere to for fixed portfolio firms freeing up people's time further to address the most pressing issues. Key changes include:

1a More flexibility on the format, content and frequency of sector Business Model & Strategy Analysis (BMSA) material, to ensure that analysis products meet the needs of individual sectors and align with the house views.
1b. There will be no minimum number of deep dives to be completed within the regulatory cycle.
1c. There is a reduction in the minimum number of proactive engagement meetings, and no core requirement for MI review.

2. **Flexible portfolio firms:** We're taking a market-focused approach to supervise our flexible portfolio. This will be through market–based activities including thematic (Pillar III) work and programmes of communication, engagement and education. We'll no longer carry out Pillar I activities on these firms.

Changing our group supervision model: We're moving to a new 'group supervision' model where sectors are responsible for dealing with issues, or regulating business units, that are relevant to their sector. Whether supervising a fixed or flexible firm, supervisors will be able to give a greater level of attention to the risks that matter most.

Which type of business will be affected? How many are estimated to be affected?

All regulated firms (55,000) across all sectors.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2015	2015	10	29.52	-3.4	-17.0

Please set out the impact to business clearly with a breakdown of costs and benefits

1.Creating more flexibility in our approach to supervising fixed portfolio firms:
1a. Overall the number of prescribed firm meetings has fallen from 7 to 4 per year for the ca 11 fixed portfolio firms formerly classified as C1; and from 5 to 4 for the ca 124 fixed portfolio firms formerly classified as C2 as a result of the move to fewer and less prescriptive meetings, decided on a risk basis, and to co-ordinated deep dive exercises. Each proactive engagement meeting is likely to be 1.5 hours with an estimated[1] 2 – 4 hours preparation time. Each meeting may have 2 or 3 firm individuals attending.

Cost saving: (3 * 11) + (1 * 124) = 157 fewer firm meetings per year @ 3.5 – 5.5 hours each per meeting @ £48 / hr (based on information taken from the Robert Half Salary Guide) with 2 to 3 attendees = £53,000 to £124,000 per year. Non-wage labour costs are considered factored in to the per hour cost basis used.

1b. Deep dives. Overall the number of deep dives would be reduced as there used to be 2 per year for fixed portfolio firms. Supervision estimates that each firm receives one less deep dive than before transition. This means that 135 firms are completing one less deep dive per cycle and another 52 firms who have moved to flexible are not receiving one at all (187 fewer deep dives).
We estimate[2] firms spend 3.5-5.5 hours preparing and taking part in these meetings per attendee, and there are 2 to 3 attendees per meeting. The latest estimates from supervision suggest that 10-15 engagements per firm are a reasonable range.
Cost saving: 187 fewer deep dives @ 10-15 engagements each @ 3.5 – 5.5 hours per meeting @ 48/hr with 2 to 3 attendees = £628000 to £2.22m .
1c. MI. We have also removed the minimum requirements around reviewing MI although in practice supervisors will still request some MI. However, frontline supervisors don't necessarily believe the saving is meaningful as the MI requested was usually information that firms had already prepared for their Boards. **Cost saving**: **Impact is negligible.**

2. Flexible portfolio firms:

The C3/4 distinction has been removed. There are 73,000 C4 firms, of which 12,000 were prioritised and received an inspection every 4 years. There are 400 C3 firms who used to have an inspection every 3 years. As a result of the change, none of these firms will have any inspections. We are looking to replace these 4 yearly inspections with outreach education work with firms, which will have no cost to firms. We estimate[3] firms spent 3.5-5.5 hours preparing

[1] *We arrived at this estimate based on our broader supervisory knowledge of how firms respond to our outputs and also on supervisory conversations with firms about their procedures. No cost benefit analysis was conducted at the time. Accordingly, no further data exists and it would be disproportionate to retrospectively collect this information.*

[2] *See footnote 1*

[3] *We arrived at this estimate based on our broader supervisory knowledge of how firms respond to our outputs and*

and taking part in these inspection meetings per attendee, and there were 2 to 3 attendees per meeting.

Cost saving: under the previous regime we had ca 400 C3 firms and 12,000 prioritised C4 firms. This suggests ca 12000/4 + 400/3 = 3133 visits per year @ 3 – 5.5 hours each per meeting @ £48 / hr (the 90th percentile of pay in the sector) with 2 to 3 attendees = £1.008m to £2.37m per year.

3. Changing our group supervision model:

Many large groups that would be fixed portfolio throughout, would now not be fixed in every sector. However, this will not affect the amount of supervisory work taking place, but only its focus between sectors. There would be no cost saving from this change.

Indirect savings from fewer firm visits:

As it is rare for firm visits to not lead to remediation requests from supervisors, the move from fixed to flexible supervision will also lead to proportionately similar savings through fewer remediation requests. However, the savings from these was considered to be exempt for BIT purposes because they are firm-specific interventions; and because our counterfactual assumption is full compliance with FCA rules.

Overall savings estimate per year, rounded to the nearest thousand: £1.689m to £4.71m (average of £3.19m) *
(*The average has been derived by taking the midpoint of £1.689m and £4.71m)

Please provide any additional information (if required) that may assist the RPC to validate the BIT Score.

<u>Glossary</u>

Business Model and Strategy Analysis (BMSA): analysis of a firm's business model and future plans to help form a view of the sustainability of the business from a conduct perspective and identify where the conduct risks are on a forward-looking basis

C1: Groups with the largest number of retail customers, and wholesale firms with the most significant market presence. They have a named supervisor and a high level of firm-specific supervision

C2: Firms and groups with large retail customer numbers and wholesale firms with a significant market presence. They have a named supervisor and a high level of firm-specific supervision

C3: Retail and Wholesale firms with a medium-sized customer base. They are supervised with a sector-based approach, with less frequent firm-specific engagement

C4: Retail and Wholesale firms with a small number of customers. They are supervised with a sector-based approach, with less frequent firm-specific engagement

Deep dives: focused investigations for fixed portfolio firms

Firm Categorisation (Conduct) Fixed: Fixed portfolio firms have a named supervisor and are proactively supervised using a firm-specific continuous assessment approach. All these firms are subject to a firm-specific supervisory strategy and an underlying work programme, which are evaluated at key governance checkpoints during the regulatory cycle. Pillar 2 issues are addressed in line with risk appetites and regulatory obligations, and firms may also be included in Pillar 3 activity where appropriate.

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also on supervisory conversations with firms about their procedures. No cost benefit analysis was conducted at the time. Accordingly, no further data exists and it would be disproportionate to retrospectively collect this information.

Firm Categorisation (Conduct):Flexible: Flexible portfolio firms are supervised through thematic and market-based work, along with programmes of communication, engagement and education activity aligned to the key risks identified in the relevant sector.

Firm Evaluation (FE): key internal governance meeting for Fixed Portfolio firms to agree view of firm and supervisory strategy.

House Views: provide a collective FCA view of what is happening within and across the sectors we regulate, enabling us to locate where problems exist within sectors and better understand the drivers of risk.

Pillar 1: proactive firm specific work through structured firm assessment and engagement.

Pillar 2: event-driven and reactive supervision: operates by dealing quickly and decisively with problems that are emerging or have already happened, and securing customer redress or other remedial work where necessary.

Pillar 3: thematic supervision: the method by which we address key conduct priorities by conducting intensive analysis of sectors or products. Thematic supervision is driven by sector risk analysis which aims to identify what is currently and potentially driving poor customer outcomes.

Proactive engagement (PE): the means by which supervisors build and maintain an up to date understanding of a firm's business model, governance, operations and culture in order to identify emerging risks.

Sector teams: embedded within the Supervision area, core functions are risk identification and mitigation, representing the FCA on sectoral issues.