Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: PS18/15: Extending the Senior Managers & Certification Regime to insurers

Lead regulator: These are dual regulated firms and the SM&CR is a joint regime. Our FCA proposals are assessed in here but the PRA is lead regulator for insurers.

Date of assessment: 06/07/2018

Commencement date: 10/12/2018

Origin: Domestic

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

Which areas of the UK will be affected? All FSMA authorised insurers

Brief outline of proposed new or amended regulatory activity

Following the 2008-09 financial crisis, in June 2012 Parliament established the Parliamentary Commission on Banking Standards (PCBS) to consider and report on professional standards and culture of the UK banking sector, and lessons to be learned about corporate governance, transparency and conflicts of interest, and their implications for regulation and for Government policy.

The PCBS concluded that public trust in banking was at an all-time low and recommended a series of measures to restore trust and improve culture. These recommendations proposed a new framework for approving and holding individuals to account.

In March 2016, we applied the Senior Managers & Certification Regime (SM&CR) to banks, building societies, credit unions and PRA-designated investment firms (a separate impact assessment was undertaken for this). Subsequent changes to the Financial Services and Markets Act 2000 (FSMA) require us to extend the SM&CR to all firms authorised to provide financial services under FSMA. This included all insurers (who are jointly regulated with Prudential Regulation Authority) and solo-regulated firms (who are solely regulated by the Financial Conduct Authority).

The three main elements of the SM&CR will apply to every firm: The Senior Managers Regime, Certification Regime and Conduct Rules:

Senior Managers Regime:

- This focuses on the most senior people in the firm. Our rules will define which roles are 'Senior Management Functions' depending on the type of firm involved. Anyone who holds a Senior Management Function needs to be approved by us before they start their role, the same as under the Approved Persons Regime. Firms also need to ensure that Senior Managers are suitable to do their jobs.

- Every Senior Manager will need to have a document that sets out what they are responsible and accountable for (a 'Statement of Responsibilities'). Firms need to give us this statement when a senior individual applies to be approved, and whenever there's a major change to their responsibilities. This is a requirement under legislation.

    - Every Senior Manager will also have a 'Duty of Responsibility' CP17/42 – which means if something goes wrong in an area for which they are responsible, we will consider whether they took 'reasonable steps' to stop this from happening. Again, this is a requirement under legislation.

- We are also applying some new responsibilities that firms will need to give their Senior Managers ('Prescribed Responsibilities'). This won't apply to some firms (such as sole traders or firms with limited permissions, and EEA branches), and more responsibilities will apply to bigger firms.

Certification Regime:

- This covers people who aren't Senior Managers, but whose jobs mean they can have a big impact on customers, markets or the firm. We set out what these roles are in our rules. We won't approve these people, but firms will need to check and confirm ('certify') that they are suitable to do their job at least once a year.

Conduct Rules:

- These are basic rules that will apply to almost every person who works in financial services. They include things like 'acting with integrity' and 'treating customers fairly'. The Conduct Rules are about improving the behaviour of all staff in financial services firms.

Extra requirements for Solvency II firms and Large Non-Directive Insurers

We are also applying some extra requirements that will only apply to the largest and most complex firms (fewer than 1% of firms regulated by the FCA). For example, these firms will need to have Responsibilities Maps and Handover Procedures.

Scope of the assessment

This assessment covers the extension of the SM&CR to insurers and associated non-Handbook guidance. The proposals were set out in CP17/26 and CP17/41. The near-final rules were published in July in PS18/15.

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

The proposals affect all 560 insurers authorised under FSMA. All of these insurers are regulated by the FCA so they are all therefore impacted.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2016	2018	10	-43.4	5.0	25.2

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

Measuring the costs

Firms incur compliance costs in meeting the requirements placed on them by regulators. For example, additional staff time may be required for training and supervision, or because new IT equipment is needed to document compliance. Some of these costs are one-off costs (for example, system changes), while others will be incurred on an ongoing basis (for example, certification or training on Conduct Rules for new joiners).

We note that this regime replaces the Approved Persons Regime. This would require similar activities to those required by the Senior Manager's Regime but firms will incur significant additional incremental costs implementing the regime and maintaining compliance with the regime. In addition, insurers have been subject to the PRA's Senior Insurance Managers Regime (SIMR), which means that these firms have already implemented elements of the SM&CR (e.g. PRA Senior Insurance Management Functions (SIMFs)) and will therefore be more familiar with these elements. This explains why the implementation costs for insurers are lower than they otherwise might have been.

We asked firms in a survey about 8 ways they may incur costs to implement each of the 11 policy elements[1], on a one-off and on an ongoing basis. These included changes to organisational structure, required adjustments (most commonly hiring new staff), training costs, staff monitoring, staff time, IT changes, and record keeping. The breadth of these questions, with an 'other cost' category, will mean all the compliance costs for implementing the Regime should have been captured.

We sent the survey to about 2,000 firms, on a legal entity level. We received responses from 255 firms. We discarded 28 responses where firms had either obviously misunderstood the purpose of the survey or provided incomplete responses. We used responses from 37 insurers in our analysis. As there are fewer small non-directive insurers (NDFs), there were fewer responses from these categories of firms.

We weighted the survey responses so that the weighted survey data accurately reflect the characteristics of the population. We expected more complex firms to incur more costs from complying with our rules and less complex firms to incur lower costs. Further, some types of firm were much more likely to respond than others. The weighting of responses made sure that our estimates of the overall costs to industry weren't biased by the differing complexity of firms or the varying levels of response rates for different types of firms.

[1] Senior Manager Functions (SMFs), Statements of Responsibilities, Prescribed Responsibilities and Criminal Record Checks, Regulatory Reference checks for SMFs and Certification Functions, Conduct Rules and the elements of the Enhanced Regime (Responsibilities Maps, Allocation of Overall Responsibility and Handover Arrangements)

We used the weighted survey data to calculate average one-off compliance costs and annual ongoing compliance costs for the sample of firms (on a legal entity basis) in the different tiers and used the number of firms in the population within these tiers to scale up and estimate costs for the whole industry.

When considering the cost estimates for the 8 cost categories and 11 policy elements, we believe that some of the numbers reported to us in the survey are unlikely to be incurred by firms in practice (some firms reported costs that we would not expect to arise from the requirement placed on firms). There are additional cost categories[2] that we are sceptical will arise but it is possible that firms would incur them. Discounting these costs enabled us to calculate a lower bound for the estimates presented in the CBA. We use the upper bound of the costs reported for calculating the BIT score.

Compliance costs to insurers

The table shows the number of insurers that will fall under the 2 tiers based on the updated data extracted in January 2018.

Tier	Number of firms
Small NDFs and ISPVs	170
Solvency II firms and Large NDFs	390
Total	560

Small NDFs and Insurance Special Purpose Vehicles (ISPVs) are subject to a streamlined regime compared to Solvency II firms and Large NDFs. For example, responsibilities maps, allocations of overall responsibility requirements and handover arrangements won't apply to small NDF insurers. Large NDFs and Solvency II firms are subject to additional requirements.

Overall, on average we expect insurers to incur one-off costs of £15,860 - £16,070 implementing the regime and then £5,760-£7,630 in ongoing costs. We separately estimated the costs for Solvency II and large NDFs and the costs for Small NDFs and small insurers in run-off to implement the regime and used these to estimate the total costs presented in the next table. However, we did not separately report the average costs for each tier in our CBA, and neither do we do so here[3].

[2] For example, one off costs associated with changes to organisational structure (e.g. recruitment or redundancies)

[3] This is because of uncertainty in these estimates. Although we contacted all small NDFs and 23 of the 42 small insurers in run-off, we had only 6 responses to our survey from these insurers, 2 of which were from small insurers in run-off. Further, the costs reported by these 6 firms varied considerably. Because of the variability of the cost estimates and the small number of responses, we consider that the averages for the 6 firms are not reliable estimates of the one-off and ongoing compliance costs for small NDFs and small insurers in run-off.

The table below shows the overall industry costs for all dual-regulated insurers.

Tier	one-off, £m	Ongoing, £m
Small NDFs and small insurers in run-off	0.8 – 0.9	0.6
Solvency II and large NDFs	8.0 – 8.1	2.6 – 3.6
Total[4]	8.8 – 8.9	3.2 – 4.2

Implementation

HMT has confirmed that the SM&CR will apply to insurance firms from 10 December 2018.

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

A detailed outline of the regime is set out in the following document:

- Insurers: https://www.fca.org.uk/publication/policy/ps18-15.pdf
- Duty of Responsibility: https://www.fca.org.uk/publication/policy/ps18-16.pdf

A cost benefit analysis was conducted for this workstream. This is available at: https://www.fca.org.uk/publication/research/cost-benefit-analysis.pdf

[4] The total costs are derived from the average cost per firm multiplied by the number of firms. Figures may not match exactly due to rounding.