Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Extending the Senior Managers & Certification Regime to solo-regulated firms

Lead regulator: FCA

Date of assessment: 16 July 2019

Commencement date: 9 December 2019

Origin: Domestic

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

Which areas of the UK will be affected? All FSMA-authorised solo-regulated financial services firms

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 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 'Enhanced' firms

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, Handover Procedures, and will need to make sure that there is a Senior Manager responsible for every area of their firm ('Overall Responsibility').

Scope of the assessment

This assessment covers the extension of the SM&CR to solo-regulated firms and associated non-Handbook guidance. The proposals were set out in CP17/25 and CP17/40. The near-final rules were published in July 2018 in PS18/14. The final rules were published in July 2019 in PS19/20.

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

The proposals affect all solo-regulated firms authorised under FSMA. Firms affected include asset managers, non-bank mortgage lenders, investment firms and consumer credit firms.

47,000 firms regulated only by the FCA are impacted.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2016	2019	10	-1970.7	229	1,144.8

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.

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 190 solo-regulated firms in our analysis. As there are fewer solo-regulated firms that will fall in the Enhanced tier, 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

[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)

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.

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 [3]. We use the upper bound of the costs reported for calculating the BIT score.

Compliance costs to solo-regulated firms

The table below shows the number of solo-regulated firms that will fall under the different tiers of the regime. Limited Scope firms are firms that will have a more limited set of requirements to apply than those within the Core tier (e.g. fewer Senior Management Functions and no Prescribed Responsibilities), while Enhanced firms will need to adhere to extra elements on top of those in the Core tier.

Tier	Number of firms
Limited Scope	26,120
Core	20,540
Enhanced	280
Total	46,940

The majority of firms will be Limited Scope firms. A significant number of firms are in the Core tier and only a very small proportion of firms are in the Enhanced tier. Firms in the Core tier will need to implement all the elements in the Core tier, while the approximately 280 firms in the Enhanced tier will have to implement both the Core and Enhanced elements.

The table below shows the average costs for firms in each tier of the regime. The average costs reported in the table are derived from the sample of firms in the Core tier, Limited Scope, and Enhanced tier in complying with all the applicable Core and Enhanced requirements (Senior Managers Regime, Certification Regime and Conduct Rules as well as the Enhancements). The figures are therefore averages over the full range of costs different types of firms might incur.

[2] For example, one off costs associated with changes to organisational structures (e.g. recruitment or redundancies)
[3] See pages 18-25

Tier	one-off, £	Ongoing, £
Limited scope	950 – 990	120 - 400
Core	18,440 – 18,620	5,730 – 7,720
Enhanced	467,470 – 469,350	61,870 – 96,410

The table below shows the overall industry-wide costs for all solo-regulated firms, broken down into one-off and ongoing costs for Limited Scope firms, Core firms and Enhanced firms[4].

Tier	one-off, £m	Ongoing, £m
Limited scope	24.7 - 25.8	3.1 - 10.4
Core	397.4 - 401.1	120.1 - 162.2
Enhanced	132.8 - 133.3	17.6 - 27.4
Total[5]	554.9 - 560.3	140.8 - 200.0

Some of the people currently requiring our approval and who won't be performing Senior Manager Functions under the new Regime will instead require Certification. For some firms, this will constitute a net cost saving. Using reported cost savings from our survey, we expect the total savings to firms of £4.6m per year.

Implementation

HMT has confirmed that the SM&CR will apply to solo-regulated firms from 9 December 2019.

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 documents:

- https://www.fca.org.uk/publication/policy/ps18-14.pdf
- Duty of Responsibility: https://www.fca.org.uk/publication/policy/ps18-16.pdf
- https://www.fca.org.uk/publication/policy/ps19-20.pdf

[4] Note: in calculating our total costs we have assumed that 43 firms in the Core tier will incur Enhanced firm costs for implementing the core elements. This is because they are large firms who we expect to have more complicated structures and a higher cost of implementing the regime.

[5] 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.