

Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: FG20/1: Assessing adequate financial resources

Lead regulator: FCA

Date of assessment: 9 July 2020

Commencement date: 11 June 2020

Origin: Domestic

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

Which areas of the UK will be affected? All

Brief outline of proposed new or amended regulatory activity

FCA supervisory work aims to reduce the likelihood of market disruption, increase the chances firms can put things right when they go wrong; and minimise harm, to consumers and the integrity of the UK financial system, as they exit the market in the event of failure.

The Finalised Guidance aims to provide more clarity to the industry regarding what we believe is the role of adequate financial resources, and the focus of our approach when assessing the adequacy of a firm's financial resources.

The Finalised Guidance also makes clear that we expect firms to consider the risks applicable to the activities they undertake, in a way that is proportionate to the scale, nature and complexity of those activities. Smaller, simpler firms are therefore not expected to incur the same level of expenditure on managing risk as larger more complex firms.

We are not proposing to make any rule changes or changes to the FCA Handbook but we provide guidance on existing rules, and in particular Threshold Conditions.

The Paper explains the purpose of, and our approach to the assessment of adequate financial resources for all firms authorised and regulated by the FCA only, subject to the Principles for Businesses (PRIN) and threshold conditions, making this more transparent, by setting out:

- The role of assessing adequate financial resources
- What we look for from firms when assessing adequate financial resources
- The FCA's expectations as to the practices firms should adopt in their assessment of adequate financial resources

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

The FCA is the prudential supervisor for approximately 48,000 regulated firms. Every Financial Services and Markets Act 2000 (FSMA) authorised firm, as well as a firm providing payment services or e-money services, is subject to the Principles for Businesses (PRIN)¹. FSMA authorised firms must also meet Threshold Conditions. This means a firm's resources must be appropriate to the regulated activities a firm carries on or seeks to carry on.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2019	2020	10	-173.5	20.2	100.8

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

We set out below our view of the key areas where firms might incur additional costs. We expect that most firms would not need to make changes nor incur costs in every area. The Finalised Guidance is targeted at all firms that the FCA has prudential supervision responsibilities for. Some firms may have approaches to assess adequate financial resources which already address the risks arising from their business models and activities, and the potential harm they may cause to consumers or to the integrity of the UK financial system. In these cases, it is possible that firms will not need to take any further action in response to our proposed guidance, meaning our proposals would result in no, or negligible, incremental costs.

The scale, nature and complexity of a firm will determine the level of detail required to establish whether the firm has adequate resources. Smaller, simpler firms are therefore not expected to incur the same level of expenditure on managing risk as larger more complex firms.

Firm Categorisation:

In line with the Cost Benefit Analysis ("CBA"), firms are categorised in the following way throughout this Impact Assessment:

- **Class 1 firms** – This includes firms subject to prudential requirements under the Capital Requirements Directive, either CRD III or CRD IV and are subject to an Internal Capital Adequacy Assessment Process (ICAAP). This group includes 166 firms that are subject to in-depth supervisory review of their own assessment of adequate financial resources, every two to four years.
- **Class 2 firms** – This group includes 2,680 firms that may be subject to our review of their own assessment of adequate financial resources on an ad-hoc basis, and required to perform an ICAAP.
- **Class 3 firms** – firms not subject regular supervisory review or ICAAP. This group includes 45,052 firms that may be subject to our review of their own assessment of adequate financial resources on an ad-hoc basis.

One off costs, namely:

- Costs related to familiarisation and gap analysis

¹ With the exception of Principle 4 - Financial Prudence – insofar as prudential responsibility is a matter reserved to the home state regulator in respect of an EEA authorised electronic money institution, EEA authorised payment institution and EEA registered account information service provider.

- Costs related to implementation and governance changes

Ongoing costs

- Costs related to ensure firms continue meet the expectations set out in the Final Guidance Our Framework: assessing adequate financial resources

Costs related to familiarisation and gap analysis²

While recognising that many firms will already meet at least the level of expectations set out in this consultation, we do recognise that it is likely that the directors of most if not all firms will expect assurance that their own practices are in line with expectations. Class 1 firms, in particular, may wish to conduct gap analysis to benchmark themselves against the consultation. This will result in some cost in terms of time firms spend reading and familiarising themselves with the consultation, and producing an analysis for the board or other committee, but we do not consider these to be material.

Class 1 firms – to familiarise themselves with the proposed guidance we assume that this will be read on average by 20 people across the firm, each taking slightly more than 2 hours, each working day being seven hours long, to do so. This covers legal, compliance, risk management, business operations and senior management. We estimate a cost of £332 per person per day; this is based on an average annual staff cost to the firm of £73,000 per person, divided by 220 working days.

For gap analysis, we assume this will be done by 4 people, from legal, compliance and risk management, each team member taking 4 days to review the document. We estimate a cost of £336 per person per day; this is based on an average annual staff cost to the firm of £74,000 per person, divided by 220 working days.

Class 2 firms – to familiarise themselves with the proposed guidance we assume that this will be read on average by 5 people across the firm, each taking slightly more than 2 hours, each working day being seven hours long, to do so. This covers legal, compliance, risk management and senior management. We estimate a cost of £382 per person per day; this is based on an average annual staff cost to the firm of £84,000 per person, divided by 220 working days.

For gap analysis, we assume this will be done by 2 people, from compliance and risk management, each team member taking 3 days to review the document. We estimate a cost of £355 per person per day; this is based on an average annual staff cost to the firm of £78,000 per person, divided by 220 working days.

Class 3 firms – to familiarise themselves with the proposed guidance we assume that this will be read on average by 2¹ people across the firm, each taking slightly more than 2 hours, each working day being seven hours long, to do so. This covers risk management and senior management. We estimate a cost of £282 per person per day; this is based on an average annual staff cost to the firm of £62,000 per person, divided by 220 working days.

² Assumptions made throughout the IA are in-line with the Standardised Cost Model (“SCM”) cost assumptions. The SCM is a framework for estimating common types of compliance costs. The cost of salaries (including 30% overheads) for large and medium firms are based on the 2016 Willis 42 Towers Watson UK Financial Services Report. Small firm salaries are sourced from a systematic review of adverts on the website of Reed, cross-referenced with other publicly available sources.

As per the SCM, costs, staff involvement, training and governance changes are expressed for large, medium and small firms and based on standard, minor or small changes in the publications. The Final Guidance is assumed to be a “standard” publication.

<https://www.fca.org.uk/publication/corporate/how-analyse-costs-benefits-policies.pdf>

For gap analysis, we assume this will be done by 1 person responsible for risk management, taking 1 day to review the document. We estimate a cost of £282 per person per day; this is based on an average annual staff cost to the firm of £62,000 per person, divided by 220 working days.

The estimated cost per person per day does not exactly match the estimated cost assumed in the FCA standardised cost model (SCM). For familiarisation, the estimated cost is higher than the SCM, because the SCM assumes this is done by compliance staff only. For gap analysis, the estimated cost is slightly lower than the SCM, because the SCM assumes this is done by legal staff only. In our estimate of costs related to familiarisation and gap analysis, based on our supervisory experience and the nature of the proposed guidance, we have assumed the work is done by a combination of staff which covers legal, compliance, risk management, business operations and senior management.

Table 1: Total one-off costs³ for familiarisation and gap analysis⁴

Class 1 firms	Familiarisation	20 people take 2 hours each to read the document	£0.4m total cost
	Gap Analysis	Team size of 4 people and 4 days for each team member to review the document	£1.0m total cost
Class 2 firms	Familiarisation	5 people take 2 hours each to read the document	£2.0m total cost
	Gap Analysis	Team size of 2 people and 3 days for each team member to review the document	£6.4m total cost
Class 3 firms	Familiarisation	2 people take 2 hours each to read the document	£10.1m total cost
	Gap Analysis	Team size of 1 person taking 1 day to review the document	£14.2m total cost
Total			£34.2m total cost

The overall one-off costs related to familiarisation and gap analysis of our proposed guidance add up to approximately £34.2m.

Costs related to implementation and governance changes

We would expect any well-run business to devote thought to the content of the paper as BAU, we understand that many firms may fall short of what we look for from firms, and our expectations as to the practices firms should adopt in their assessment of adequate financial resources.

Costs related to implementation and governance changes do not include any costs related to gap analysis, as the shortcomings in a firm's approach should be captured within the

³ For the calculation of costs, we have added an allowance for overheads of 30% to all time costs to account for non-wage labour costs. This allowance is only reflected in the table with the costs and not in the description of assumptions

⁴ For the calculation of gap analysis costs, we have included an adjustment based on the number of words in the document. The standardised cost model assumes the number of days based on a 15,000 words document. Because this document contains around 12,900 words, this results in an adjustment to the number of days each person takes

familiarisation and gap analysis. Cost captured here only include those related to the implementation of necessary changes.

Table 2: Total one-off costs for implementation and governance changes

Class 1 firms			Negligible. These should mostly be within BAU costs**
Class 2 firms	Change management project team	On average 6 people take 2 working days working on the project	£7.5m total cost*
	Company board	On average 8 board members take 1.5 hours each	
Class 3 firms	Change management project team	On average 2 people take 2 working days working on the project	£38.9m total cost*
	Company board	On average 2 board members take 1.5 hours each	
Total costs			£46.5m total costs*
<p>*assumes implementation costs are incurred by 1/3 of Class 2 firms and 1/2 of Class 3 firms. Some Class 2 firms will be subject to supervisory review therefore will not likely need to make changes, Half of class 3 firms will not be expected to make changes as they are small or may already be meeting expectations. The other half will be expected to make some changes to meet expectations.</p> <p>**Class 1 firms will have existing approaches to assess AFR and so may not need to take additional steps. They are subject to prudential requirements and in-depth supervisory review of their resources. This is also in line with SCM assumptions that where new requirements are closely aligned with current business-as-usual practices, then the regulation may be met without material incremental costs compared to the counterfactual.</p>			

Ongoing costs⁵

The guidance applies to firms that are subject to threshold conditions and/or PRIN, who must hold adequate financial resources. They should take reasonable steps to identify and measure its risks and have appropriate systems and controls to measure them prudently, at all times. Our view is that, once firms have implemented necessary changes, the costs to maintain this on an ongoing basis should be minimal and fall within BAU costs. This is because the paper clarifies how firms should be meeting Threshold Conditions, which they must do at all times currently. So, any amendments made will fall into BAU costs going forward and form part of ongoing requirements to meet Threshold Conditions. For one third of class two firms and half of class 3 firms that have implemented changes, this may include a new process to confirm, on an annual basis, that the assessment is appropriate. We believe that the remaining class 2 and class 3 firms will not be required to implement changes given their small size and will therefore not incur costs.

We assume that these class 3 firms will incur ongoing costs in terms of the time that directors will take to prepare for and participate in annual directors' discussions, and the cost of staff to prepare the pack for the directors. We assume that once a year, on average two directors spend

⁵ Assumptions made throughout the IA are in-line with the Standardised Cost Model ("SCM") cost assumptions. The SCM is a framework for estimating common types of compliance costs. The cost of salaries (including 30% overheads) for large and medium firms are based on the 2016 Willis 42 Towers Watson UK Financial Services Report. Small firm salaries are sourced from a systematic review of adverts on the website of Reed, cross-referenced with other publicly available sources. As per the SCM, costs, staff involvement, training and governance changes are expressed for large, medium and small firms and based on standard, minor or small changes in the publications. The Final Guidance is assumed to be a "standard" publication. <https://www.fca.org.uk/publication/corporate/how-analyse-costs-benefits-policies.pdf>

1.5 hours per meeting, and that 1 staff spends half a day preparing the pack. We estimate a director's hourly rate as £68. This is based on an estimated salary of £104,000 p.a., 220 annual working days, and each working day being seven hours long. We estimate a cost of £282 per staff person per day; this is based on an average annual staff cost to the firm of £62,000 per person, divided by 220 working days.

Table 3: Total ongoing costs

Class 1 firms		Negligible. These should mostly be within BAU costs
Class 2 firms		Negligible. These should mostly be within BAU costs
Class 3 firms	On average 1 team member taking half day to prepare pack	£10.1m total cost per year*
	On average 2 board members take 1.5 hours each	
*assumes ongoing costs are incurred by 1/2 of Class 3 firms		

Table 4: Total overall costs

One-off costs	One-off costs of considering our proposed guidance	Class 1 firms	£1.4m total cost
		Class 2 firms	£8.4m total cost
		Class 3 firms	£24.3m total cost
	One-off costs of changing the approach to assessing adequate financial resources	Class 1 firms	Negligible. These should mostly be within BAU costs
		Class 2 firms	£7.5m total cost*
		Class 3 firms	£38.9m total cost*
Ongoing costs	Class 1 firms	Negligible. These should mostly be within BAU costs	
	Class 2 firms		
	Class 3 firms	£10.1m total cost per year**	
*assumes implementation costs are incurred by 1/3 of Class 2 firms and 1/2 of Class 3 firms			
**assumes ongoing costs are incurred by 1/2 of Class 3 firms			

Benefits

A clear and transparent communication of the FCA's expectations as to the practices firms should adopt can reinforce acceptable standards of practices and behaviours and be a critical factor in

minimising harm caused to consumers or to the integrity of the UK financial system and, therefore, benefit consumers and firms, as well as the market as a whole.

Harm will be minimised by:

- Driving up standards in risk management and controls framework
- Increasing the likelihood of preventing harm
- Increasing the likelihood of firms putting things right when they go wrong
- Appropriate wind-down planning
- Improved trust in financial services

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

[FG20/1: Assessing adequate financial resources](#)

[CP19/20: Our Framework: Assessing Adequate Financial Resources](#)