

## Regulator Assessment: Qualifying Regulatory Provisions

**Title of proposal:** PS16/22: Strengthening accountability in banking and insurance: regulatory reference final rules

**Lead regulator:** FCA

**Date of assessment:** 28 September 2016 (publication date)

**Commencement date:** 7 March 2017

**Origin:** Domestic

**Does this include implementation of a Cutting Red Tape review?** N/A

**Which areas of the UK will be affected?** Whole of the UK

### Brief outline of proposed new or amended regulatory activity

#### Status Quo

References are a tool for firms to share relevant information on individuals to support their assessment of potential new recruits as suitable to perform their role i.e. they are fit and proper.

Under the Approved Persons Regime, if a firm is considering appointing a person to perform a 'controlled function' (i.e. a function subject to regulatory approval) requests a reference from the current or former employer, the recipient firm is required to provide all relevant information about that person.

Under existing rules:

- only candidates for controlled functions are captured;
- a firm is not mandated to request a reference but, if it does, the current or former employers is required to provide it;
- the firm supplying the reference should include information around the fitness and propriety of the individual and should exercise due skill and care in preparing the reference;
- all firms are required to have adequate policies, processes systems and controls of record keeping of information.

#### Rationale for the Changes

The Financial Services (Banking Reform) Act 2013 created the legislative framework that underpins the new individual accountability regime for banks. This reflected the recommendations of the Parliamentary Commission on Banking Standards, which was appointed to consider and report on professional standards and culture in the UK banking sector in the wake of the global financial crisis.

In 2015, the Fair and Effective Market Review published further recommendations that aim to raise standards in fixed income, currency and commodity (FICC) markets. One of FEMR's recommendations was that 'the FCA and the PRA should consult on a **mandatory form for regulatory references**, to help firms prevent the 'recycling' of individuals with poor conduct records between firms...'.

The FCA and the PRA accepted this recommendation and issued a joint consultation on new rules for regulatory references in October 2015. PS 16/22 sets out the response to that consultation and the final rules for regulatory references.

These rules form part of the new accountability regimes for banks, insurers, building societies and credit unions introduced in March 2016.

### Summary of Changes

The new requirements for banks, insurers, building societies and credit unions were:

- Requirement to request regulatory references going back six years rather than five years.
- Requirement to update regulatory references if new material information came to light.
- Standard template for references
- Requirement to disclose disciplinary action relating to a Conduct Rule breach (rather than all Conduct Rule Breaches as originally consulted on), going back 6 year rather than 5, and serious misconduct beyond that period
- Clarifying that a firm must not enter into any arrangements or agreements that limit their ability to disclose relevant information.
- Limiting the requirement to disclose 'all relevant information' to 6 years (with the exception of serious misconduct).

The new rules will come into force in March 2017.

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

Primarily deposit takers and insurers, with some impact for other firm types.

How many are estimated to be affected? The new requirement for 'all relevant information (i.e. the last bullet in previous section) will impact all firms (approximately 55,000). The other changes impact a subset only i.e. banks and insurers (approximately 2,000 firms)

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2016	2017	10	-3.6	0.4	2.0

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

To estimate the costs of the additional changes to the regulatory reference regime, we have used data collected as part of the CP14/13 CBA which has been reported in a separate IA. In CP14/13, we reported that there were 12,945 approvals of persons undertaken by the FCA in a six month period in 2013, implying 25,890 per year. We also reported that there were 150,000 approved persons. It also reported the total number of approved persons within banks, building societies and credit unions was around 50,000. We also know that around 13.8% of approved roles were within insurance firms (see FCA Data Bulletin 2), meaning that around 21,000 approved persons are located within insurance firms.

In terms of the regulatory changes made, only three are likely to lead firms incurring additional incremental costs. We assess the costs of these three elements separately. The costs from including disciplinary action related to Conduct Rule breaches in the references are likely to be caught in our estimate of the cost of the templates. Firms already have a duty to record breaches and the template will catch the costs of including these breaches in regulatory references. We would not expect any costs to arise from preventing arrangements that limit disclosure as this was a preventative measure and we are unaware that firms have entered into such arrangements.

#### Estimating the costs of the additional year of regulatory references (from 5 to 6 years)

Given the increase in the number of additional references and hence the relatively low cost of providing references we would not expect firms to undertake systems changes costs as a result of this change. Rather, we would expect HR to administer these additional requests. We expect firms to have to administer an additional 2,100 references as a result of moving from 5 to 6 years on an ad-hoc basis. We therefore calculate a yearly ongoing cost for this change.

We calculate this by estimating the average churn rate among approved persons to be 17.3% (25,890/150,000). The requirement to seek additional references only applies to persons being appointed to banks, building societies, credit unions and insurers and who moved firms more than 5 years ago but less than 6 years ago. Hence an additional reference is required under the new rules. Given the average churn only 17.3% of potential appointees would have moved during this time. Further only 47.1% of these appointees will be moving to affected firms where the requirement applies. Hence an additional 2,100 references are required (25,890 x 17.3% x 47.1%).

To estimate the cost of additional references, we assume that a reference takes 1 hour to complete for an HR manager contractor at £400 per day (Source: Robert Walters Salary Survey 2016 (p18) - middle of range), and therefore each additional reference costs £57.

We therefore expect firms to incur ongoing costs from this change of £120,000 per year (£57 x 2100).

#### Requirements to update regulatory references

Again firms are likely to update references in an ad-hoc manner. We would expect only a small number of updated references to be provided. While we cannot estimate the number, we would expect that this number would not exceed around 1% of approved persons. Consequently, we would expect references to be updated for no more than 700 approved persons a year (1% x 150,000 x 47.1%). Again we assume that updating the reference would take an hour of an HR manager contractor's time at a cost of £57.

We therefore expect firms to incur ongoing costs from this change of £40,000 per year (57 x 700).

#### The cost of requiring a template for references

These templates were introduced to make it clearer for firms to provide the information required under previous regulatory changes. However, firms may have incurred some additional costs in filling templates in. The templates are relatively short and do not require additional information that was previously required. These requirements only apply if an approved person is joining a regulated firm and was previously at bank, building society, credit union or insurer. We estimate that around 12,200 appointments will be affected by this change per year (25,890 x 47.1%). Each of these will require 1.04 references (6 years x 17.3% churn rate). As a result, 12,600 references will need to be provided using the template.

Assuming it takes 15 minutes of an HR manager contractors' time (£14) to fill in the template, the total cost of requiring the template is £180,600 per year (14 x 12,600).

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

**Links to CP15/31, PS 16/22 and CP14/13, and PS 15/21 and PRA PS3/15 (re insurers):**

<https://www.fca.org.uk/publication/consultation/cp14-13.pdf>

<https://www.fca.org.uk/publication/policy/ps16-22.pdf>

<https://www.fca.org.uk/publication/consultation/cp14-13.pdf>

<https://www.fca.org.uk/publication/policy/ps15-21.pdf>

<http://www.bankofengland.co.uk/prd/Documents/publications/ps/2015/ps315.pdf>