Regulator Assessment: Qualifying Regulatory Provisions

Title of proposal: Staff incentives, remuneration and performance management in consumer credit firms (rules and guidance)

Lead regulator: FCA

Date of assessment: 09/03/2018

Commencement date: 01/10/2018

Origin: Domestic

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

Which areas of the UK will be affected? All regions

Brief outline of proposed new or amended regulatory activity

We will make new rules and non-Handbook guidance as a result of thematic work and subsequent (positive) consultation with industry. The rules will come into force on 1 October 2018. More specifically:

- A new high-level rule (CONC 2.11) requiring firms to have adequate arrangements to detect and manage any risk of non-compliance with their regulatory obligations arising from their remuneration or performance management practices.
- A proportionality provision requiring a firm, when deciding how to comply, to take into account the nature, scale and complexity of its business. It would also need to take into account the nature and range of financial services and activities it undertakes in the course of that business.
- Non-Handbook guidance on the purpose of the proposed new provisions. In particular, to remind firms of their existing obligations under Principle 3 of our Principles for Businesses sourcebook (PRIN) and Senior Management, Systems and Controls sourcebook (SYSC) 4.1.1R. This will ensure firms identify and effectively manage risks to customers from their policies, procedures and practices for the remuneration and performance management of their employees, appointed representatives and agents who work with customers.
- The Non-Handbook guidance also sets out examples of relevant measures and procedures which firms can introduce to manage these risks.

These measures clarify existing requirements within the Senior Management, Systems and Controls (SYSC) sourcebook and Principle 3, which both require adequate management of risks. We felt additional guidance would be beneficial to support firms' compliance with the rules.

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

The new rules and guidance will apply to firms that carry out consumer credit activity, both sales and collections, and have staff who deal directly with customers. We estimate this to be around 10,700 firms.

Price base year	Implementation date	Duration of policy (years)	Business Net Present Value	Net cost to business (EANDCB)	BIT score
2017	2018	10	-65.2	7.6	37.9

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

Costs

Our Cost Benefit Analysis (CBA) assessed the costs our new rules and guidance would impose on the firms to which they apply, beyond the costs of complying with the current regulatory requirements. The key areas where we expect firms might incur additional costs are:

- consideration of our rules and guidance
- changes to incentive schemes and performance management measures to reduce/eliminate risk of non-compliance
- detection and management of risks arising from incentive schemes and performance management
- knock-on costs e.g. IT systems, training, cash flow

To estimate the value of incremental costs we surveyed a sample of 35 firms across 15 sectors that may be affected[1]. We also ensured that our sample covered the full range of credit-related regulated activities.

We would not expect most firms to need to make changes, and incur costs, in every area. Furthermore, from the results of our CBA survey we expect smaller firms to be the least impacted:

- 73% of respondents indicated that our proposals would result in no incremental costs (including firms within each of the 15 sectors). However, a minority of respondents across a range of sectors indicated that there would be material incremental costs. We have estimated the overall cost to impacted firms in the table below, taking into account the size of the firm, business sector and reported estimated costs.

[1] Sectors covered are: Personal Loans, High-cost Short-term Credit, Home Collected Credit, Catalogues/Mail Order, Store/Credit cards, Logbook Loans, HP/Conditional Sale, Guarantor Lending, Pawn Broking, Primary Credit Broking, Secondary Credit Broking, Credit references / Credit Information Services, Debt Collection, Debt Management, Debt Administration

Category of firm	Estimated number of firms impacted	Average net one-off costs per firm (£)	Average ongoing cost per firm (£ pa)	Estimated total one-off cost (£m)	Estimated total ongoing cost (£m pa)
Firms with 3 – 15 staff	7,398	69	-	0.51	-
Lending >15 staff	1,013	2,231	1,565	2.26	1.59
Credit Broking 16 - 500 staff > 500 staff	 1,814 98	 6,944 16,000	 1,800 4,840	 12.60 1.57	 3.27 0.47
Debt >15 staff	415	5,420	1,043	2.25	0.43
Total for impacted firms	10,738	1,786	536	19.18	5.76

The level of incremental cost incurred by a firm will depend on a variety of factors, including the risks presented by its staff incentive or performance management arrangements and the robustness of its current risk management approach.

Every firm with fewer than 15 employees that responded to our survey indicated that there would be no incremental costs from our new rules.

For firms with only 1 or 2 employees, or no employees, we expect in most cases our proposals would not be relevant and we expect costs for these firms to be zero or minimal overall. For many of these firms, the senior managers are also the owners of the firm, have very close oversight of their staff, and play key roles in both performance management and risk management. We might expect some of these firms to make changes in response to our new rule and guidance, but these changes could be made within existing resources without incurring significant additional costs.

For firms with between 3 and 15 employees, we expect that they may incur some one-off costs to read and consider our messages, but ongoing costs will be minimal. We have estimated one-off costs based on average pay information provided by firms in our thematic review with 10 or fewer sales or collections employees and based on an estimate of 5 hours' work to review and consider how to implement the new rule and guidance.

For firms in the debt category, no firms indicated that there would be any ongoing cost from our proposals, and only one firm indicated that there would be a one-off cost. However, our thematic and supervisory work suggests that we would expect some firms to make changes, particularly in the debt management sector, which may have ongoing cost implications. We have therefore included responses from lenders to calculate the average cost for firms in the debt category.

Of the responses that indicated there would be an incremental cost, many of these included costs that related to wider risk management and compliance costs, not those resulting directly from our new rules. However, it is difficult to separate or apportion costs relating to our new rules alone. We have therefore used the full amounts provided by respondents. Whilst this has significantly over-estimated the costs, it does give an indication of the upper end of the range of possible costs.

Benefits
We would expect that some firms will change their incentive schemes and related controls to effect a shift in focus from sales or collections volumes to customer outcomes and customer service, this may lead to benefits including:

- increased customer satisfaction leading to greater customer loyalty and retention, increased sales, or reduced customer acquisition costs
- fewer complaints from customers and the associated costs of dealing with those complaints
- improved staff satisfaction leading to reductions in staff turnover and associated costs
- improved governance and risk management

These benefits have not been quantified as most firms that responded to our survey indicated it was difficult or impracticable to estimate the benefits to them and therefore did not give a value for these benefits. These benefits relate in large part to expected changes in customer behaviour, which are difficult to predict before implementing changes.

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

See CBA in Annex 2 of CP17/20

https://www.fca.org.uk/publication/policy/ps18-07.pdf