

Title: Senior Managers & Certification Regime: extension to foreign branches IA No: RPC14-HMT-2196(2) Lead department or agency: HM Treasury Other departments or agencies:	Impact Assessment (IA)		
	Date: July 2015		
	Stage: Final		
	Source of intervention: Domestic		
	Type of measure: Primary legislation		
Contact for enquiries: MarketConduct@hmtreasury.gsi.gov.uk			

Summary: Intervention and Options	RPC Opinion: GREEN
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Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Two-Out? Measure qualifies as
£m -78.02	£m -78.02	£m 6.89	Yes IN

What is the problem under consideration? Why is government intervention necessary?

The financial crisis and more recent incidents highlighted weaknesses in the regulatory system and in the performance and behaviour of individuals who work in banks. The Financial Services (Banking Reform) Act 2013 implements some recommendations of the Parliamentary Commission on Banking Standards to strengthen individual accountability in domestic UK banking (including UK subsidiaries of foreign banks). Secondary legislation is needed to apply these reforms to individuals working in UK branches of foreign banks ("foreign branches").

What are the policy objectives and the intended effects?

The policy objective is to extend the new regime for regulating individual conduct in banking ("Senior Managers and Certification Regime" - SM&CR) to cover individuals working in foreign branches and so to ensure a uniform regime and approach to regulating individual conduct, and improved standards of individual conduct and performance in all parts of the banking sector that operates in the UK.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Two options have been considered: 'do nothing' and extending the SM&CR to foreign branches. There are no alternatives to regulation as the regime can only be applied in rules made by financial services regulators using statutory powers and the regulators could only take enforcement action against individuals within the appropriate legal framework. The preferred option is justified by higher standards of individual conduct and performance in foreign branches which should reduce the risk of misconduct in key financial markets, harming users of those markets and damaging market integrity more generally.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: July 2020					
Does implementation go beyond minimum EU requirements?				N/A	
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		Micro Yes	< 20 Yes	Small Yes	Medium Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)				Traded: N/A	Non-traded: N/A

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: _____ Harriett Baldwin _____ Date: July 15th 2015 _____

Summary: Analysis & Evidence

Policy Option 1

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2014	PV Base Year 2015	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -78.02	High: -70.76	Best Estimate: -78.02

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	34.5	5.4	80.1
High	36.7	6.0	87.3
Best Estimate	36.7	6.0	87.3

Description and scale of key monetised costs by 'main affected groups'

Foreign branches: costs of setting up and operating systems to submit applications for approval of senior manager appointments, to check initially and to recheck annually that senior managers and staff performing 'significant harm functions' are fit and proper, to issue certificates, to notify regulators of certain disciplinary action taken against staff and to ensure staff are aware of rules of conduct that apply to them.
Regulators: costs of processing senior manager applications.

Other key non-monetised costs by 'main affected groups'

None

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	1.1	9.3
High	0	1.1	9.3
Best Estimate	0	1.1	9.3

Description and scale of key monetised benefits by 'main affected groups'

Foreign branches: saving of the costs of submitting applications for approval of persons to perform controlled functions under existing approved persons regime.
Regulators: saving of the costs of processing applications for approval of persons to perform controlled functions under existing approved persons regime.

Other key non-monetised benefits by 'main affected groups'

Benefits to the wider economy from better conduct and performance of staff in foreign branches, reflected in (i) better market integrity in financial markets, and (ii) reduction in mis-selling or other detriment to consumers of financial services provided by foreign branches.

Key assumptions/sensitivities/risks

Discount rate 3.5

The key assumptions are: the costs per small foreign branch will be the same as those for a small UK bank adjusted to reflect the nature of branch and requirements of EU law; the costs per large foreign branch will be 10% of the costs for a large UK bank; and that 10 of 174 foreign branches should be regarded as large. The overall NPV is particularly sensitive to the latter two assumptions because of the very high cost of putting certain systems in place in banks with large numbers of staff.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			In scope of OITO?	Measure qualifies as
Costs: 7.7	Benefits: 0.8	Net: -6.9	Yes	IN

Evidence Base

Introduction

1. The financial crisis highlighted a number of weaknesses in the regulatory system, in the structure of the banking industry and in the performance and behaviour of many of the individuals who work in that industry and in the financial services industry more widely. The Government took steps to reform the previous tripartite system of financial services regulation through the Financial Services Act 2012, establishing: the Financial Policy Committee, as a strong and expert macro-prudential authority within the Bank of England; the Prudential Regulation Authority (PRA) as a subsidiary of the Bank of England; and a new independent conduct of business regulator, the Financial Conduct Authority (FCA). The Financial Services (Banking Reform) Act 2013 implemented the recommendations of the Independent Commission on Banking, which examined the problems posed by banks considered “too big to fail”, including introducing a ring-fence around banks’ deposits to separate important everyday banking activities from investment banking activities.
2. The Financial Services (Banking Reform) Act 2013 also implemented a number of recommendations of the Parliamentary Commission on Banking Standards (PCBS) to put in place a new framework for regulating the behaviour of individuals working in banking.¹ The Act applied the reforms to UK deposit-taking institutions (banks, building societies and credit unions) and to UK investment firms that are prudentially regulated by the PRA as well as being subject to conduct of business regulation by the FCA. It also gave the Treasury the power to extend the reforms by Order so that they apply in relation to the UK branches of foreign credit institutions and investment firms (“foreign branches”).
3. This final stage impact assessment follows a previous consultation stage impact assessment on the costs and benefits of making an Order and bringing foreign branches within the scope of the new regime for individual accountability introduced by the Financial Services (Banking Reform) Act 2013. These impact assessments have not considered those reforms as a whole.
4. In this impact assessment, the assumptions for the monetised costs and benefits to foreign branches of the new regime have been partly based on the data and assumptions included in the joint PRA and FCA consultation paper *Strengthening accountability in banking: a new regulatory framework for individuals* particularly the report prepared by Europe Economics for the Financial Conduct Authority (FCA).² The adjustments made are explained below but reflect the assumption that the FCA and PRA would apply the new regime to foreign branches in broadly the same way as it will be applied to UK banks other than where it is necessary to allow for the nature of a branch (rather than a self-standing entity) and to comply with EU law or other international obligations.
5. The consultation stage impact assessment accompanied a Treasury consultation document issued to meet the requirements of section 71A(5) of the Financial Services and Markets Act 2000.³ There was one comment on the impact assessment in the responses to the consultation which stated: “... we believe many of the underlying assumptions in the impact assessment, especially in relation to the methodology used to calculate costs, significantly underestimate the impact the proposed changes will have on firms, especially in relation to third country requirements”. In preparing this final stage impact assessment, the Treasury has re-examined the assumptions made in the light of this comment and the work of the FCA and PRA in preparing cost benefit analyses for their subsequent joint consultation *Strengthening accountability in banking: UK branches of foreign firms*, which contained the regulators’ respective proposals for extending, and where appropriate tailoring the new regime to foreign branches in an appropriate and proportionate manner.⁴ As a result, some

¹ See the PCBS final report *Changing banking for good* (HL Paper 27, HC 175, published on 19 June 2013) and the Government’s response (Cm 866, published on 8 July 2013).

² FCA CP 14/13 PRA CP 14/14 published on 30 July 2014 and available on the FCA and Bank of England websites. The PRA CBA is in Annex 1, the FCA CBA is in Annex 2 and the Europe Economics report for the FCA *Cost Benefit Analysis of the New Regime for Individual Accountability Final Report* (3 July 2014) is in Annex 10.

³ *Regulating individual conduct in banking: UK branches of foreign banks* published on 17 November 2014. The Government’s response and decision to proceed with making the Order was announced in a Written Ministerial Statement on 3 March 2015.

⁴ FCA CP 15/10 PRA CP 9/15 published on 16 March 2015 and available on the FCA and Bank of England websites. The PRA cost benefit analysis is in Annex 2 and the PRA cost benefit analysis in Annex 3.

aspects of this impact assessment have been revised. These are considered in detail in the sections on monetised costs and benefits below.

Background

6. The main way in which individuals in the financial services industry (including foreign branches) are currently regulated is the Approved Persons Regime in Part V of the Financial Services and Markets Act 2000 (FSMA). The key features of the regime are:
 - a. all key individuals who perform what are termed 'controlled functions' in a financial services firm require the regulator's prior approval as 'approved persons';
 - b. controlled functions, which are designated by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) in rules, are split into two categories - 'significant influence functions' (SIFs) – such as the chief executive – and 'customer-dealing functions' (CDFs) – such as the provision of financial advice to customers;⁵
 - c. a firm must submit an application for approval to the regulators who will decide whether the individual is a fit and proper person to perform the controlled function in question;
 - d. approved persons must comply with statements of principle made by the regulators;
 - e. the regulators may take enforcement action under FSMA against approved persons for breaches of a statement of principles or for being knowingly concerned in a breach of regulatory requirements by the firm.
7. The key features of the new regime for individual accountability (the Senior Managers and Certification Regime – SM&CR) for regulating individuals in banks, building societies and credit unions and dual FCA/PRA-regulated investment firms (relevant authorised persons – RAPs) are:
 - a. the 'presumption of responsibility' so that senior managers can be subject to regulatory enforcement action when a RAP fails to comply with regulatory requirements in their area of responsibility unless they can show that they the steps that it would be reasonable to expect a person in their position to take to prevent the contravention occurring;
 - b. mandatory statements of responsibility, setting out the aspects of a RAP's business a senior manager is responsible for;
 - c. requiring the register of approved persons kept by the FCA to state who is a senior manager in a RAP, and give details of regulatory action taken against them;
 - d. requiring RAPs to verify before making an application to a regulator for approval of a candidate for a senior management position or another role requiring regulatory pre-approval that the person is fit and proper to perform that role in the firm;
 - e. requiring RAPs to consider at least once a year thereafter, whether there are any grounds on which a regulator might seek to withdraw its approval of a senior manager or another person approved by a regulator and, if so, to notify the regulator of those grounds;
 - f. requiring RAPs to verify before appointing an employee to a role in which he or she could do significant harm to the firm (and annually thereafter), that the person is fit and proper to perform that role in the firm, and issue a certificate of that fact to the employee (which lasts for 12 months);
 - g. requiring RAPs to maintain up-to-date records of employees who have been issued certificates which could be made available to the regulators when required;
 - h. allowing the PRA and FCA to make enforceable rules of conduct for all employees in RAPs. These rules can apply to senior managers, other pre-approved persons, certified persons and other employees;
 - i. requiring RAPs to notify the appropriate regulator when they take formal disciplinary action against senior managers, other persons approved by the regulators, and other employees (not

⁵ The FCA may designate both SIFs and CDFs in all types of firm. The PRA may only designate SIFs and only in the firms that it regulates.

- limited to employees performing significant harm roles). Formal disciplinary action means giving a formal written warning, dismissal, suspension or clawing back remuneration; and
- j. requiring RAPs to notify senior managers, other persons approved by the regulators, and other employees (not limited to employees performing significant harm roles) of the rules of conduct that apply to them.
8. The Financial Services (Banking Reform) Act 2013 also included provision for a new criminal offence. A senior manager can be guilty of this offence when he or she is involved in a decision which causes a UK RAP to fail and his or her conduct falls far below the conduct that could reasonably be expected of a person in a senior management position. However, the offence can only be committed by senior managers in UK RAPs; the offence cannot be committed by senior managers in foreign branches and the extension of the SM&CR to foreign branches would not make senior managers in foreign branches potentially liable for the offence. The new criminal offence is not considered further in this impact assessment.
 9. The detailed application of the SM&CR will be determined by PRA and FCA policy and implemented through their rules. The draft rules for UK RAPs and the regulators' policies are set out in their consultation paper but in broad terms the PRA and FCA envisage:
 - a. restricting regulatory pre-approval to senior managers – probably a narrower range of key individuals than currently perform significant influence functions, focusing on the top two levels of management – and ending pre-approval of all customer dealing functions;
 - b. applying certification by the firm (see paragraph 7(f) above) to all current approved persons who are not classed as senior managers, any material risk takers as defined for the purposes of the PRA Remuneration Code who are not currently approved persons and who will not be senior managers, and the line managers of certified persons who will not be senior managers; and
 - c. applying rules of conduct (see paragraph 7(h) above) to senior managers, certified persons and (FCA only) all other bank employees who are not in purely ancillary functions.

Rationale for intervention and implications for foreign branches

10. The PCBS report emphasised the need to strengthen accountability and incentives for bankers to behave ethically and in a way that supports the long-term sustainability of banks. The PCBS also concluded that the approved persons regime had failed to set clear expectations for individuals, in particular senior individuals performing key roles in banks, and did not provide a system in which senior managers could be held to account for the failures that took place within banks that were brought to light by the financial crisis or in subsequent revelations of misconduct. The Government accepted the PCBS analysis and agreed that low standards of conduct and managerial performance, particularly in relation to risk management, were important contributing factors to the financial crisis. The reforms in the Financial Services (Banking Reform) Act 2013 seek to address these concerns.
11. This rationale for intervention applies equally in relation to foreign branches as it does for UK RAPs. Staff in foreign branches may be dealing on behalf of their firms in UK financial markets or advising UK consumers. A foreign branch may therefore pose similar risks to market integrity or the interests of consumers as a UK RAP.
12. A foreign branch is not a separate entity from its parent organisation. It differs, therefore, from a foreign-owned subsidiary in the UK which is subject to the UK regulatory regime in precisely the same way as other UK companies. However, in principle, FSMA (including the approved persons regime) applies to foreign branches in the same way that it does to UK firms, subject to changes for EEA branches to align with the split of home/host state responsibilities under the relevant EU single market directives.⁶
13. In practice, because a branch is just a part of its parent entity, the approved persons regime (or other parts of the UK regulatory regime) cannot be applied in an identical fashion to branches. In

⁶ A foreign firm from outside the European Economic Area (EEA - the EU plus Iceland, Liechtenstein and Norway) which wishes to establish a branch in the UK must apply for a FSMA Part 4A permission in the same way as a UK firm. An EEA firm may establish a branch in the UK by virtue of a 'passport' from its home State under the relevant EU Single Market Directive. (The firm is then authorised under Schedule 3 to FSMA rather than under Part 4A of FSMA.)

addition, EU law further limits the ability of UK regulators to impose requirements on UK branches of EEA firms. These limitations will continue to apply in the same way if the SM&CR is applied to foreign branches and they are reflected in the assumptions made in this impact assessment.

14. Many overseas financial services firms operating in the UK, including the largest foreign banks and investment firms, do so through a combination of a branch and one or more subsidiaries in an integrated operation. Applying the SM&CR to foreign branches would avoid the disadvantage of having to apply two different regimes to the UK operations of groups that operate in this way.

Options considered

15. Two options have been considered:

- a. 'do nothing' – in this option the SM&CR would not be extended to foreign branches and the approved persons regime would continue to apply in essentially the same way as it would do now. There would be no additional costs or benefits in this option and it is, therefore, taken as the base case and a summary table has not been included in this assessment. The PRA and FCA could make changes to the approved persons regime rules as a consequence of the changes being made by the introduction of the SM&CR for UK RAPs but such changes would be made independently (and could happen in any event) and no allowance for them is included in this impact assessment;
- b. option 1 – in this option, the SM&CR would be applied in relation to foreign branches. The FCA and PRA would make the detailed provision in their rules, subject to the considerations set out in paragraphs 12 to 14. The quantified costs and benefits included in this option reflect the PRA's and FCA's current assumptions about the rules they would make and the implications for foreign branches of these rule changes.

Monetised costs and benefits: foreign branches

Monetised costs

16. The estimates of the monetised costs of the application of the SM&CR to foreign branches are based on the data and assumptions included in the cost benefit analysis in the joint PRA and FCA 2014 consultation paper *Strengthening accountability in banking: a new regulatory framework for individuals*.⁷ This section explains the assumptions behind the adjustments made to those estimates to derive the cost assumptions used in this impact assessment.
17. The Europe Economics report for the FCA provides estimates of the one-off and ongoing compliance costs for banks based on a sample of banks and investment firms. There are separate estimates for building societies and credit unions. Separate estimates have also been prepared for large banks and investment firms (defined as those having annual incomes greater than £1 billion) and small banks and investment firms. (No bank would be likely to be considered a small firm as conventionally defined for most other policy purposes. Equally no foreign branch would be a small firm in the conventional sense. See paragraphs 50 to 52 below.)
18. Most foreign branches will be comparable to small UK banks. Foreign branches do not have networks of local offices in the UK and most operate in wholesale markets without ordinary retail clients. Foreign branches are more likely, therefore, to resemble smaller or more specialised banks in the UK than larger UK banks.
19. However, a small number of branches would be considered to be 'large' on the basis of the Europe Economics test discussed above. Although they do not resemble large UK banks in terms of having a large retail network of local offices around the UK and the associated levels of staffing, they clearly differ from small UK banks in having significant staffing and in having, therefore, to make significant investments (especially in one-off costs) to set up and run the systems needed to comply with some aspects of the SM&CR.

Cost estimates for small branches

⁷ See paragraph 4 and footnote 2.

20. The assumptions are:

- a. starting point - cost estimates for small UK banks
- b. FCA and PRA policy – foreign branches to be treated in a similar way as UK banks of a corresponding size and complexity but taking account of the nature of a branch, or the requirements of EU law (or other international obligations), potential impact of foreign branches on the regulators’ objectives and the regulators’ commitment to apply the regime to branches in an appropriate and proportionate way.
 - (i) Other things being equal, the PRA and FCA would normally apply regulatory requirements to foreign branches in the same way as they would to UK banks. However, a branch is not (by definition) a separate entity from its foreign parent and there will be certain matters, primarily connected to prudential regulation, in which UK regulators will have little or no role in relation to the branch. In relation to branches of banks in EEA states, prudential matters are reserved for the home State supervisor (i.e. the regulator of the parent entity).
 - (ii) In relation to the conduct of foreign branches, UK regulators will have a much bigger role, as the conduct takes place in the UK. This is recognised in EU law which allows host State supervisors of EEA branches to regulate conduct. Most approved persons in foreign branches perform customer dealing functions (as is the case in UK banks – see paragraph 30 below) and so are probably mainly engaged in conduct-related matters than in prudential matters.
 - (iii) On this basis, the SM&CR costs for foreign branches should be the same as the corresponding costs for comparable UK banks apart from the costs associated with the appointment of senior managers. These costs should be lower reflecting the smaller number of senior managers in foreign branches.
- c. Senior managers – the PRA will not be able to designate senior managers in EEA branches and does not expect to designate more than 1-2 senior managers in most small and medium branches – the local head of the branch and possibly one other depending on the nature of the branch’s activities in the UK – in each non-EEA branch. FCA expects to designate a small number of senior managers in small and medium EEA branches and non-EEA branches. The total number of designated senior managers is expected to be between 5 or 6 depending on the branch’s size and complexity.
 - (i) In relation to EEA branches, the regime reflects the requirements of EU law. UK regulators could not approve a senior manager in an EEA branch dealing with prudential matters because the question of whether such a person was fit and proper is reserved to the home State authorities under the single market directives applying to banking and financial services.
 - (ii) For non-EEA branches, UK regulators could approve senior managers but a branch is unlikely to need the full range of senior managers that a self-standing entity would have and some senior management responsibilities could be discharged by persons in the parent entity outside the UK. (Prudential oversight of a branch will always be primarily a matter for the home State regulator of the parent entity.)
 - (iii) There is more scope for the FCA to designate senior managers in EEA branches as well as in non-EEA branches. However, the precise numbers of FCA senior managers in any branch will depend on the branch’s activities in the UK and the number of designated senior managers per branch could vary considerably.
 - (iv) There will be considerable overlap between FCA and PRA senior management functions. Effectively, therefore, foreign branches will not incur costs in relation to both FCA and PRA designated senior managers.
 - (v) For UK small banks and investment firms, the PRA and FCA expect between them to designate the top two levels in a company as senior managers, covering board members and senior executives below board level. This may mean no more than about 20 individuals per legal entity – probably fewer than the numbers who perform SIF functions.
 - (vi) It is assumed therefore that SMF costs per foreign branch will be 25% of the FCA-imposed costs per UK small bank and investment firm.

- d. Certification – the PRA will only be able to designate functions that can be only be performed by certified persons (“significant harm functions) in non-EEA branches. The FCA will be able to designate significant harm functions in both EEA and non-EEA branches. Most certified persons are likely to be performing FCA-designated significant harm functions as they will currently be performing customer dealing functions (which only the FCA can designate). It is assumed therefore that foreign branches will not incur any additional costs in putting in place or operating systems to certify persons to perform PRA-designated significant harm functions.

Cost estimates for large branches

21. The assumptions are:

- a. Starting point – cost estimates for large UK banks
- b. FCA and PRA policy – foreign branches to be treated in a similar way as UK banks of a corresponding size and complexity but taking account of the nature of a branch, or the requirements of EU law (or other international obligations), potential impact of foreign branches on the regulators’ objectives and the regulators’ commitment to apply the regime to branches in an appropriate and proportionate way.
- c. Size - large branches resemble large UK banks in having significant numbers of staff.
 - (i) Headcount is the most relevant measure of size for considering the senior managers and certification regime as the impact of a some key features of the regime (certification (see paragraphs 7(f)) and 7(g), notification of disciplinary action (see paragraph 7(i) and training in rules of conduct for staff (see paragraph 7(j)) will depend on the numbers of staff involved. As a result, large UK branches will have to make substantial investments in order to put in place the necessary systems as well as incurring costs in complying with these requirements on an ongoing basis. However, complying with the senior managers regime (paragraphs 7(b) to 7(e)) will be relatively less significant for large branches as the number of senior managers will not increase *pro rata* with overall staff numbers.
 - (ii) PRA and FCA figures indicate that the largest UK banks have an average global headcount of about 115,000 but these figures include overseas staff in banks with significant operations outside the UK. The average UK headcount for the largest banks will be lower, probably between 80,000 and 90,000.
 - (iii) PRA and FCA figures indicate that the average headcount of the largest foreign branches in the UK is about 8,000. This may also be an overestimate as some branches operate in the UK in conjunction with a banking subsidiary of the same international group (which will already be subject to the SM&CR). However, on this basis, it seems reasonable to assume that the compliance costs for a large branch would be 10% of the compliance costs of a large UK bank. No further adjustment is made to allow for the smaller number of senior managers in a foreign branch when compared with a UK bank (see paragraph 20(c) for the adjustment for small branches.)

Numbers of branches

22. The number of foreign branches (154) used in the previous consultation stage impact assessment was taken from the list of banks operating in the UK published by the PRA for June 2014.⁸ The corresponding number taken from the April 2015 list is 155.
23. However, further work by the FCA indicates that the numbers of foreign firms operating in the UK which have a permission to accept deposits and are not insurers (i.e. meet the technical definition of a bank) ranges from 174 to 447. The higher figure includes 273 firms that do not have any approved persons in the UK and are unlikely to be active. It is assumed, therefore, that none of these firms will keep the permission to accept deposits (which would mean they should comply with SM&CR requirements in future). The lower figures probably also includes a number of firms who do not act as banks and may therefore decide to give up the permission to accept deposits. Other firms may decide to keep the permission and comply with SM&CR requirements.

⁸ Available on the Bank of England website.

24. LOW and HIGH estimates of the monetised costs of applying the SM&CR to foreign branches have been made based on 155 and 174 branches respectively. It has been assumed in both cases that 10 of these branches would be large, reflecting analysis made by the FCA and PRA. None of the 19 additional branches in the HIGH estimate figure would be large. The best estimate of NPV is calculated using the HIGH estimate of the number of foreign branches i.e. assuming that all 174 foreign branches keep the permission to accept deposits and comply with SM&CR requirements.

Summary of cost calculations for foreign branches

25. The following tables summarise the calculations made based on these assumptions for both the LOW estimates and the HIGH estimate of the number of foreign branches.

One-off costs (incurred in 2015)

		Small branches	Large branches
A1	Number of branches (LOW)	145	10
A2	Number of branches (HIGH)	164	10
B	SMF costs/branch	£48,400	£131,300
C	Certification etc costs/branch	£39,100	£55,100
D	Conduct rules etc costs/branch	£27,000	£1,608,200
E	One-off costs/branch (B to D)	£114,500	£1,794,400
F1	Total one-off costs (LOW) (A1 x E)	£16,602,500	£17,944,000
G1	TOTAL (LOW)		£34,546,500
F2	Total one-off costs (HIGH) (A2 x E)	£18,778,000	£17,944,000
G2	TOTAL (HIGH)		£36,722,000

Ongoing costs (incurred each year from 2016 to 2024)

		Small branches	Large branches
A1	Number of branches (LOW)	145	10
A2	Number of branches (HIGH)	164	10
B	SMF costs/branch	£6,100	£31,100
C	Certification etc costs/branch	£22,000	£17,700
D	Conduct rules etc costs/branch	£6,900	£38,200
E	Ongoing costs/branch (B to D)	£35,000	£87,000
F1	Total ongoing costs (LOW) (A1 x E)	£5,075,000	£870,000
G1	TOTAL (LOW)		£5,945,000
F2	Total ongoing costs (HIGH) (A2 x E)	£5,740,000	£870,000
G2			£6,610,000

Monetised benefits

26. Under option 1 the existing approved persons regime would be replaced by the SM&CR. Foreign branches will therefore receive a monetary benefit by not having to prepare and submit applications to the FCA and PRA for approved person status for their staff. The value of this benefit each year is equal to the number of applications per year multiplied by the average cost of each application.

27. An approved person application is required every time a person (the “candidate”) is to perform a controlled function. Thus applications are required if a candidate joins a firm from another firm (even if the candidate is already performing the same controlled function in the other firm) or if a candidate takes over a controlled function as a result of promotion or other internal job changes (even if the candidate had been previously approved to perform that controlled function in the firm). The application is made by the firm not the candidate.
28. The number of applications is equal to the number of approved persons working for foreign branches multiplied by the turnover rate. FCA estimated (July 2014) that there are about 15,285 approved persons working in foreign branches performing 16,273 controlled functions. (An approved person may perform more than one controlled function.) It is not possible to estimate a reliable turnover rate for approved persons in foreign branches. However, based on the total numbers of approved persons and applications for all approved person roles in financial services in recent years, an industry wide average turnover rate would about 20% (i.e. average time in post is 5 years).
29. On this basis the number of applications a year is: $15,285 \times 20\% = 3,057$.
30. The Europe Economics report for the FCA estimates that it costs a firm £350 on average to prepare and submit an approved person application. This average has been calculated for the financial services industry as a whole and therefore reflects the full range of types of firms, approved person roles and types of candidates. As over 15,000 of the 16,273 controlled functions in foreign branches are customer dealing functions (CF30) which is the commonest type of controlled function in UK banks (where there are about 36,000 CF30 roles), it is assumed that £350 is a reasonable of the cost of approved person applications for roles in foreign branches. On this basis, the annual saving to foreign branches from removing the requirement to submit approved person applications is: $3,057 \times £350 = £1,069,950$.
31. There will be no transitional benefits to foreign branches from ceasing to have to make approved person applications under the existing regime.

Monetised costs and benefits: regulators

32. The regulators will incur only incremental one-off costs in putting in place new systems to process senior manager applications, receive and process other information from firms etc. The regulators will also incur ongoing costs in operating the new system, primarily in processing senior manager applications.
33. However, the regulators are putting place systems to apply the SM&CR to UK banks, which can be used in relation to foreign branches and the number of senior manager applications in foreign branches will be low. The regulators will not therefore need separate systems to process senior manager applications from foreign branches and it is therefore assumed that the regulators will incur no one-off costs in this respect.
34. Ongoing costs for the regulators are likely to vary considerably depending on whether the application is merely subject to desk-based processing or whether the candidate is also interviewed by the regulator. For the purposes of this impact assessment, it is assumed that only the candidates for PRA-designated senior management functions in non-EEA branches will be interviewed.⁹ This probably overstates the number of senior manager candidates that the PRA wishes to interview but there may be senior manager candidates whom the FCA wishes to interview. Based on FCA data, the average cost of processing a desk-based application is assumed to be £50 while the average cost of processing an interview-based application is assumed to be £1,000.
35. The number of applications will depend on the number of branches and the turnover rate for branch senior managers. Assuming a 20% turnover rate for senior managers and the assumptions about numbers of senior managers per branch made in paragraph 28 above, there will be about 186 applications a year (with 33 interviews) for the LOW estimate of branch numbers, and about 209 applications (with 36 interviews) for the HIGH estimate. On the basis, the total annual cost to the regulators of processing senior manager applications will range from about £40,000 a year (LOW estimate) to £45,000 (HIGH estimate).

⁹ Interviews are carried out jointly by the PRA and FCA.

36. The savings to the regulators from not having to operate the existing approved persons regime for foreign branches will also be small. The FCA assume that the average cost of processing an approved persons application is £50. Assuming as above, 3,057 approved person applications a year means an ongoing saving (benefit) for the regulators of £152,850 (= £50 x 3,057).
37. There will be no transitional benefits.
38. The regulators recover their costs in fees which are paid by regulated persons. Costs and benefits to the regulators are therefore included in the calculation of the equivalent annual net cost to business (EANCB).

Non-monetised costs and benefits

Benefits

39. The introduction of the SM&CR for UK RAPs is expect to produce non-monetised benefits by addressing the weaknesses of the current regulatory system identified by the PCBS and evidenced in their final report. Similar benefits should be obtained by extending the SM&CR to foreign branches albeit on a smaller scale reflecting both the smaller number of relevant firms and because a branch is, by definition, not a whole firm. The main reasons for non-monetised benefits are:
 - a. the creation of a more flexible regime which gives regulators more options for increasing compliance with appropriate standards of behaviour;
 - b. strengthened individual accountability for bank senior managers, including through the introduction of “statements of responsibilities” and ‘reversing the burden of proof’ which will only apply to senior managers;
 - c. the ability to provide for better focused approvals of senior managers through the introduction of conditional and time-limited approvals.
40. The main benefits of extending the SM&CR to foreign branches would take the form of (i) benefits in terms of better market integrity, particularly in wholesale markets in which branches of international banks are likely to be most active, and (ii) benefits to consumers of financial services who suffer smaller losses as a result of mis-selling or other forms of misconduct by staff in foreign branches, where such branches deal with markets in which ordinary consumers are active.
41. These benefits cannot be easily quantified in relation to foreign branches as they would depend in part on the extent that foreign branches were engaged in particular activities which could give rise to misconduct or other forms of economic or social harm in the UK as well as the scale of those activities in the UK. However, the potential scale of the wider benefits in terms of market integrity can be illustrated by considering the possible effect of a narrowing of bid-offer spreads in financial markets. One of the possible consequences of a perceived lack of market integrity is that market makers and other similar traders will increase the spread between the price at which they are prepared to buy a financial asset (the bid price) and the price at which they are prepared to sell a financial asset (the offer price) in order to protect themselves from misconduct by others.¹⁰ This spread is a real cost to the customers of financial traders and a narrowing of the spread would constitute a resource benefit (i.e. it is not a transfer).
42. The scale of activity on some financial markets is enormous. For example, the Bank for International Settlements estimates that the global average daily turnover across FX instruments was over \$5 trillion in April 2013, with over 40% taking place in the UK so the impact of any reduction in spreads could be significant. Benefits in terms of a reduction of mis-conduct in consumer facing markets are likely to be less as foreign branches are typically less active in these markets.
43. The non-monetised benefits of option 1 also include benefits for the 25 integrated groups which operate through branches and subsidiaries in the UK. Integrated banking groups comprise the largest foreign firms operating in the UK and probably stand most to benefit, therefore, from the

¹⁰ This assumes that the effect of misconduct is to make it more likely that market makers will pay too much for the financial instruments they purchase or be induced to ask too little for the financial instruments they sell. Increasing the bid-offer spread is a way market makers can protect themselves from the losses that the misconduct causes. The potential losses are passed on in this way to end users (i.e. households, other businesses and governments) who have not engaged in misconduct or take the form of a reduction the scale of activity, which may disadvantage end users indirectly.

extension of the SM&CR to branches. These groups will be subject to only one regime rather than two separate regimes (i.e. UK subsidiaries would be subject to the SM&CR while branches would remain subject to the existing approved persons regime) and would be able to establish a single process for managing their senior managers and certified persons in their UK operations. Individuals in these groups commonly perform the same senior management or significant harm functions across the different UK legal entities. Extending the SM&CR to them, should therefore help to promote operational consistency in these groups as well as preventing arbitrage between UK banks and foreign branches.

44. In addition, having a single regime for international banks operating in the UK through a combination of a branch and subsidiaries reduces the opportunity for regulatory arbitrage by shifting risk-taking employees and activities from the subsidiary to the branch. Regulatory arbitrage could have detrimental consequences for market integrity and the protection of customers of the integrated group or compel the regulator to increase the resources put into supervising these groups to prevent adverse consequences occurring. Operating two different regimes for branches and subsidiaries could also have adverse effects on competition.

Costs

45. Foreign branches will incur more diffuse costs from having to manage more complex processes and operations etc as a result of the application of the SM&CR. The foreign entity (of which the branch is a part) will also be affected by this greater complexity and take the SM&CR into account in making plans for the branch or in wider location decisions.

Risk and sensitivity analysis

46. The cost estimates in this assessment are very sensitive to the assumptions made about the numbers of large branches, and the about the one-off costs per large branch. As the table of on-off costs in paragraph 25 shows, the one-off costs of setting up systems to ensure employees are trained in conduct rules etc (line D in the table) dominate the figures of cost per branch, with the result that one-off costs for 10 large branches are practically the same as the one-off costs for 145 or 164 small branches.
47. If the assumptions made about these on-off costs or about the number of branches which should be regarded as large are materially changed, the resulting total cost estimates would be significantly different. The overall NPV is not disproportionately sensitive to the number of small branches within the 145 to 164 range.

Wider impacts

Equalities impact

48. The Government has considered its obligations under the Equality Act 2010 and does not believe this measure will impact upon discrimination or other prohibited acts, equality of opportunity or good relations towards people who share relevant protected characteristics and others under that Act.¹¹ All UK residents are affected to a greater or lesser extent by misconduct in the banking sector and will benefit in the same way from the application of the SM&CR to foreign branches.

Environmental, social and sustainable development impacts

49. The Government does not anticipate any impact upon greenhouse gases, wider environmental issues, health and well-being, human rights, the justice system, rural proofing and sustainable development.

Impact on small firms and micro-businesses

50. Extending the SM&CR to foreign branches will not have a disproportionate impact on small firms or micro-businesses.

¹¹ The protected characteristics under the Equalities Act 2010 are: age, disability, gender reassignment, pregnancy and maternity, race, religion or belief, and sex, sexual orientation.

51. Foreign branches may be small businesses when considered in isolation from the parent entity. Some foreign branches are also operated in conjunction with a UK subsidiary of the foreign parent and it is possible, though perhaps unlikely, that the UK operations of the group could be a small business. However, the parent entity will be an international bank (and part of an international group) which has chosen to establish a branch in the UK. It is most unlikely that any financial institution which operates through cross-border branches would ever be regarded as a small business in practice.
52. An international bank operating a branch in the UK could not therefore be micro-business and it would not be appropriate, therefore, to treat any foreign branch in isolation as a micro-business. Micro-businesses are not therefore formally excluded from the scope of the measure and no specific mitigating actions are proposed.

Impact on competition

53. The extension of the SM&CR to foreign branches is unlikely to have a significant adverse effect on competition. Foreign branches are in competition with UK entities that will be subject to the SM&CR as UK RAPs. Applying the SM&CR to foreign branches could reduce any adverse effects on competition from subjecting groups with both branches and subsidiaries in the UK to two different regimes.
54. The introduction of the SM&CR may affect the location decisions of the parent entities which are considering whether to establish a branch in the UK. But the SM&CR will be only one of a large number of factors which will need to be considered and it is not clear that the effect on international banks, which will already be used to dealing with a range of (probably complex) regulatory regimes in a number of countries, will be significant. The regulators' commitment to apply the SM&CR proportionately to foreign branches should also help to mitigate this risk.
55. Applying the SM&CR to foreign branches may limit the extent of any transfer of business from the UK subsidiaries of international banks to branches. As a UK bank, a UK subsidiary will be subject to the full UK SM&CR.

Conclusion

56. The Government considers that the benefits of extending 'the SM&CR to foreign branches outweighs the cost.
57. The Government therefore intends to make an Order under section 71A of the Financial Services and Markets Act 2000. Subject to Parliamentary approval, the Order will come into force on 7 March 2016.