Opinion: EANDCB validation
Origin: Domestic
RPC reference number: RPC17-FCA-3596(1)
Date of implementation: July 2016

Restrictions on the retail distribution of regulatory capital instruments

Financial Conduct Authority (FCA)

RPC rating: validated

Description of the measure

The Financial Conduct Authority (FCA) believes that convertible securities and mutual society shares pose particular risks for retail customers. The FCA has introduced rules to prevent convertible securities being sold to ordinary retail customers and has introduced requirements to check that prospective retail clients meet certain criteria before mutual society shares are marketed. The new rules replace an earlier supervisory approach by the FCA which it believed did not sufficiently protect retail investors from the risk of entering into inappropriate transactions.

Impacts of the measure

The assessment explains that the changes will affect a range of businesses including banks, building societies and specialist wealth managers. The assessment explains that the FCA consulted widely with these groups in production of its cost-benefit analysis. The FCA expects firms to incur costs in relation to training, resulting in a total one-off cost of between £2.8 million and £5.2 million. The introduction of systems for client categorisation, to ensure products are only marketed to certain investors, results in one-off costs of between £0.5 million and £1.1 million with ongoing costs of between £200,000 and £1.7 million.

Compliance confirmation requirements impose a one-off cost of between £50,000 and £200,000 with ongoing costs of between £400,000 and £2 million. The introduction of an appropriateness test for non-advised sales of mutual society shares results in a one-off cost of between £2 million and £4 million and ongoing costs of between £1.8 million and £ 8.8 million. Requirements to maintain detailed records lead to an ongoing cost of between £0.1 million and £0.5 million per annum. The FCA also describes detail of how the new requirements will lead to a reduction in sales of relevant products. This leads to an ongoing loss of profit of between £0.1 million and £1 million per annum.

The RPC verifies the estimated equivalent annual net direct cost to business (EANDCB) of £9.3 million. This will be a qualifying regulatory provision that will score under the business impact target.

Quality of submission

As initially submitted, the assessment did not provide sufficient evidence to support a number of the assumptions, which meant that the RPC did not consider it fit for purpose. Following the RPC's initial review, the FCA submitted a revised assessment which addresses this issue by providing more detail to support the assumptions. In particular, the estimates relating to the development of a compliance confirmation process now makes reference to a previous cost-benefit analysis and estimates of lost revenue from the restriction on retail investors are now supported by a greater level of analysis assuming that dealing commission equates to 1% of the typical value of sale.

Departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	£9.3 million
Business net present value	-£80.3 million

RPC assessment

Classification	Qualifying regulatory provision (IN)
EANDCB – RPC validated[1]	£9.3 million
Business Impact Target (BIT) Score[1]	£46.5 million

Michael Gibbons CBE, Chairman

[1] For reporting purposes, the RPC validates EANCB and BIT score figures to the nearest £100,000.