FINANCIAL CONDUCT AUTHORITY

Consultation Paper

CP23/24***

Capital deduction for redress: personal investment firms

November 2023

How to respond

We are asking for comments on this Consultation Paper (CP) by **20 March 2024**.

You can send them to us using the form on our website.

Or in writing to:

Advisers, Wealth & Pensions
Consumer Investments Directorate
Financial Conduct Authority
12 Endeavour Square London
E20 1JN

Email:
cp23-24@fca.org.uk

When we make rules, we are required to publish an account of the representations we receive and how we have responded to them. We are also required to publish a list of the names of the respondents who made the representations, where those respondents consent to the publication of their names. In your response, please indicate whether or not you consent to the publication of your name. For further information on confidentiality of responses, see the Disclaimer at the end of this CP.

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Foreword from the Chief Executive

Good investment advice can, and does, play a vital role in consumers' lives, helping people meet their financial goals no matter whether they are buying a house, planning for retirement or anything in between.

Over recent years we have seen what happens when things go wrong, and the devastating impact poor investment advice can have. Too often those firms which have got things wrong do not take responsibility for their mistakes with the financial burden of those mistakes falling instead on the Financial Services Compensation Scheme (FSCS) and its levy payers.

Incredibly since 2016, personal investment firms exiting the market have left nearly £760m in FSCS compensation costs; 95% of this was generated by just 75 firms.

While the FSCS levy has been falling overall recently, we have heard calls from the industry to take further steps to fix the underlying issues. We received over 250 responses to our Call for Input on the Consumer Investments Market and the Compensation Framework Review. These responses delivered a clear message – polluters should pay for the redress costs they generate.

Today we are acting. We are setting out proposals for consultation to require personal investment firms (PIFs) to be more prudent and set aside capital for potential redress liabilities at an early stage. If they do not hold enough capital to cover their potential redress liabilities, they will be required to retain assets until such point that they do.

We are mindful of the cumulative load on small investment advisers, not just from regulatory costs but the wider environment as well, including the FSCS levy. We have already set higher standards for this sector including through the Consumer Duty and our work on defined benefit transfers.

Our proposals are designed to be proportionate to minimise the burden on firms and target the firms most likely to cause redress liabilities. We estimate annual compliance costs to small firms will be around £1,000. Around 500 sole traders and unlimited partnerships will also be excluded from the requirement to retain assets under these rules.

We really want to hear what the industry and consumer groups think of these proposals. Given the importance of getting this right we are undertaking a longer than normal consultation period – 16 weeks – and plan an extensive programme of industry and consumer group outreach to hear your views.

If we don't act these costs will continue to fall on firms and ultimately consumers in the form of higher fees, lower trust and continued consumer harm. We look forward to working with you as part of the consultation.

Nikhil Rathi
Chief Executive

Capital deduction for redress: personal investment firms (PIFs)

Proposals:

- PIFs to set aside capital for potential redress liabilities at an early stage
- PIFs not holding enough capital for potential redress liabilities will be required to retain assets

Why are we proposing this?

£760m

in redress paid by FSCS for PIFs that left the market between 2016-2022

95%

of this redress caused by 75 firms

20,000

consumers affected, with average compensation of £38,000

We want to:

ensure the **polluter pays**

make firms with redress liabilities **more resilient**

reduce the burden on the FSCS and on industry

enable consumers to receive redress earlier

incentivise firms to give **good advice**

To reduce the burden on smaller firms our proposals are proportionate and targeted:

- They build on existing requirements, eg Consumer Duty
- We estimate only a third of the market will have to set aside capital
- Only 2% of firms subject to asset retention requirements
- Estimated annual compliance cost for smaller firms of £1000

We want to test our proposals with industry:

Extended 16-week consultation period

Extensive industry outreach planned

To give feedback and find more details please visit www.fca.org.uk/publications/consultation-papers/cp23-24-capital-deduction-for-redress

Chapter 1

Summary

Why we are consulting

1.1 The proposals will apply to personal investment firms (PIFs), ie firms that mainly provide advice and arrange deals in retail investment and pensions products. These firms are often referred to in the market as investment advisers. We are concerned that some PIFs are causing consumers harm. We are seeing significant redress liabilities falling to the Financial Services Compensation Scheme (FSCS).

1.2 Addressing this harm is a key focus of our ongoing supervision as well as enforcement action. PIFs are subject to prudential regulation by the FCA. We therefore want to strengthen our prudential requirements so that PIFs have to hold more capital for redress.

1.3 This consultation sets out our plans to require PIFs to be more prudent and set aside capital for potential redress liabilities at an early stage. Our intervention is specifically designed to be proportionate, build on existing obligations and target the firms that generate redress liabilities. We propose to incorporate these changes into Chapter 13 of the Interim Prudential Sourcebook for Investment Businesses (IPRU–INV), which contains the existing prudential regime for PIFs.

1.4 Our proposals are designed to ensure the advice market is working better for the firms in it and the consumers who depend on it. These proposals will improve the incentives for firms to deliver better consumer outcomes in the first place and improve firm resilience when things go wrong. Building on these foundations, the Advice Guidance Boundary Review (AGBR) aims to ensure that consumers get the help they want, at the time they need it, and at a cost that is affordable, to help them make informed financial decisions.

1.5 As part of this Consultation Paper, we have included a section for discussion to explore broader improvements to the prudential regime for PIFs in Chapter 6.

Who this applies to

1.6 This consultation will affect:

- PIFs, including potential new market entrants

1.7 The consultation will also be relevant to:

- consumers who receive pensions or investments advice and other intermediation services
- professional and trade bodies representing PIFs
- consumer organisations

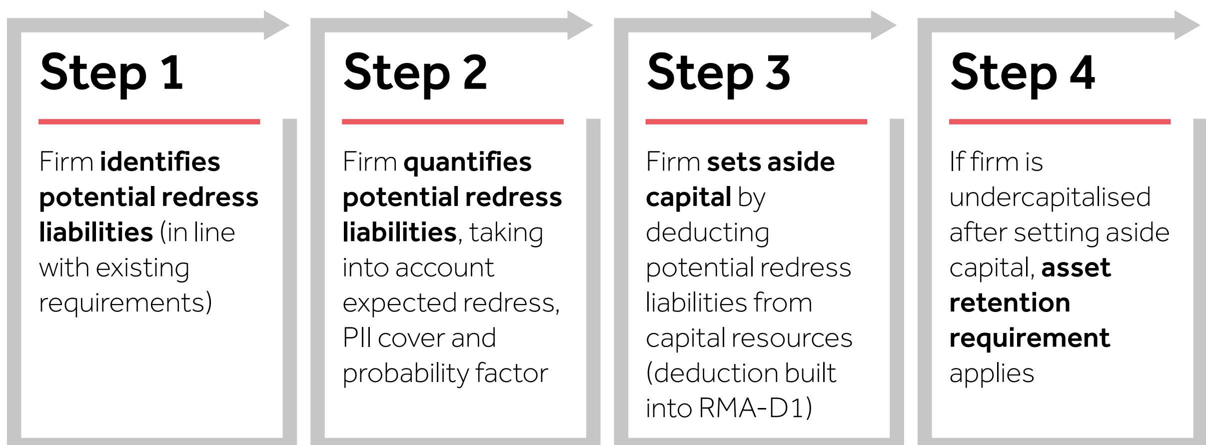
- providers of professional indemnity insurance (PII) to PIFs
- providers of investment platform, professional and other services to PIFs
- compliance consultancies, auditors and other professional services that support PIFs
- all firms that pay into the Life Distribution and Investment Intermediation (LDII) funding class of the FSCS

What we want to change

1.8 We propose to make several changes to IPRU–INV 13. In summary, these would:

- require PIFs to quantify an amount for their potential redress liabilities
- require PIFs to set aside capital resources for potential redress liabilities through a new capital deduction, and
- require PIFs with potential redress liabilities that fall below their capital requirements to comply with an asset retention requirement

Diagram 1: Overview of proposed remedy



1.9 Our proposals build on existing regulatory requirements which require firms to monitor their activities and ensure they have adequate capital to pay appropriate redress where they have caused harm to their customers. Diagram 2 summarises how these new proposals fit alongside existing requirements.

Diagram 2: How our proposals fit alongside existing regulatory requirements

Existing requirements and new proposals	Summary
Existing requirement: minimum capital requirement	PIFs must have and maintain minimum capital resources of at least £20,000 (or if higher, 5-10% of a firm's annual income from investment business).
Existing requirement: maintaining appropriate financial resources	Every authorised firm must meet the threshold conditions, which require firms to have appropriate financial resources commensurate to the risk of harm and nature of their business. Principle 4 (set out in PRIN 2.1.1R) also requires these firms to have adequate financial resources. As we have explained in Finalised Guidance 20/1, these requirements include the need to have the financial resources to provide redress to consumers.
Existing requirement: maintaining adequate PII	PIFs are required to maintain PII cover or a comparable guarantee for any claim for loss or damage the firm may be liable for.
Existing requirement: identifying potential redress liabilities	Under existing complaints handling rules, all firms must identify recurring or systemic problems, for example by identifying root causes common to types of complaint. Under the Consumer Duty, all firms must monitor consumer outcomes to identify whether retail customers have suffered foreseeable harm as a result of the firm's acts or omissions.
Existing requirement: systems and controls	All firms must maintain effective processes to identify, manage, monitor and report the risks they are, or might be, exposed to.
Existing requirement: complaints handling	Under existing complaints handling rules, all firms must have effective and transparent procedures for handling complaints reasonably and promptly.
New proposal: Quantifying potential redress	Our proposed rules require PIFs to quantify an overall amount for all the potential redress liabilities it has identified. This will consist of unresolved redress liabilities (where a firm has already received but not resolved a complaint) and prospective redress liabilities (where a firm has identified recurring or systemic problems or foreseeable harm which may lead to an obligation to provide redress).
New proposal: Setting aside capital for potential redress	Once PIFs have quantified an overall amount for potential redress, they would be required to set aside capital resources to pay the potential redress through a new capital deduction.
New proposal: Applying an asset retention requirement	Our proposed rules require PIFs with potential redress liabilities that fall below their capital requirements to comply with an asset retention requirement.

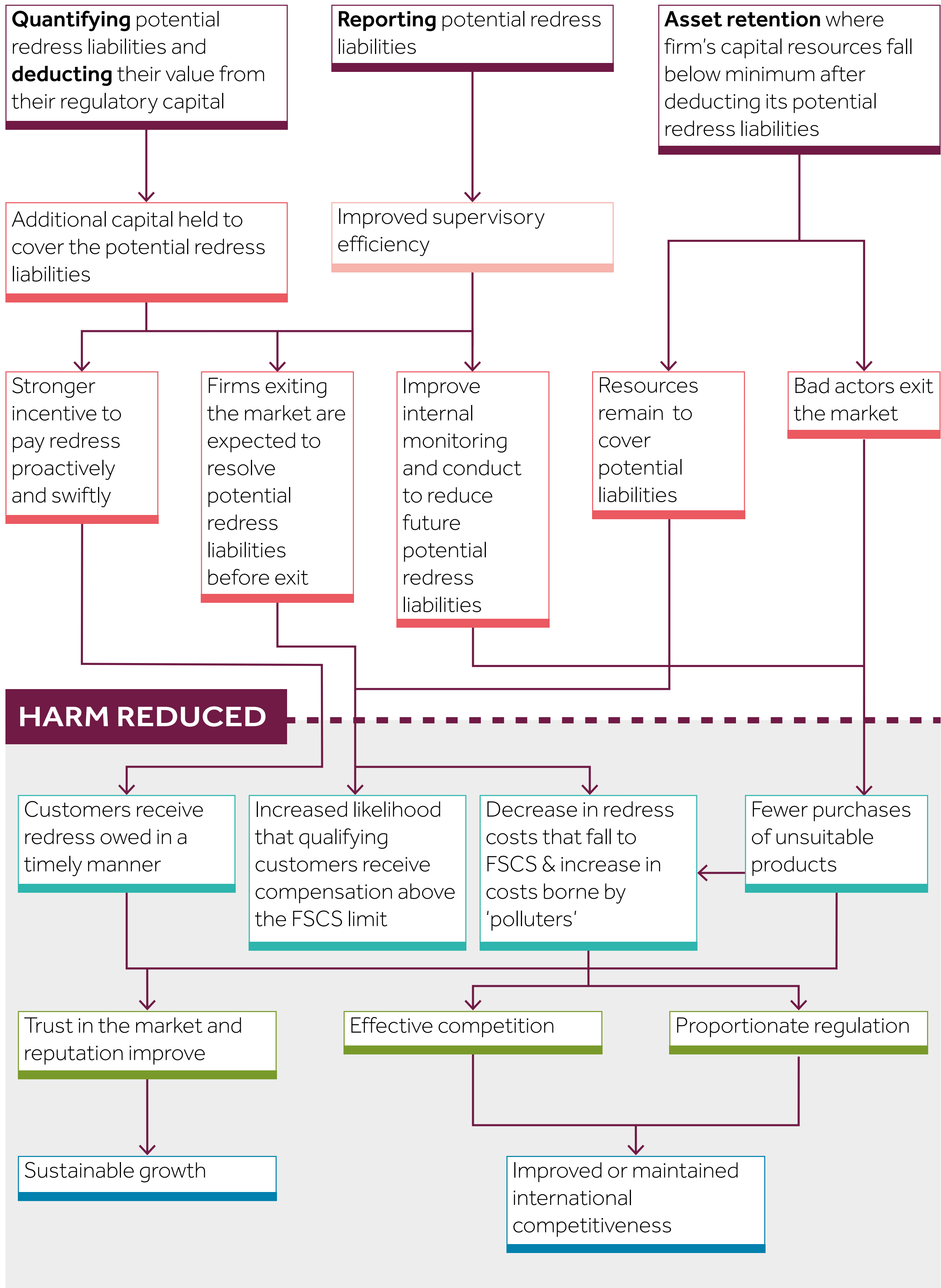
Existing requirements and new proposals	Summary
Existing requirement: providing redress	Firms should resolve complaints at the earliest possible opportunity and comply promptly with redress awards or settlements. If firms identify foreseeable harm, they are also required to investigate the circumstances, assess what remedial action or redress may be appropriate, and comply promptly with any offer of remedial action or redress that a consumer has accepted.

Outcome we are seeking

1.10 Our aim is to promote culture change by incentivising firms to resolve existing complaints and issues quickly and resolve recurring or systemic problems to help future customers. The proposals will also incentivise PIFs to improve their practices to reduce the need for them to set aside capital for potential redress liabilities. The outcomes we want to see are greater numbers of consumers receiving the full redress they are owed by the firm that caused the harm and a decrease in the redress costs that fall to the FSCS.

1.11 The proposals will streamline our supervisory work with problem firms, and we believe they will deter bad actors from operating in the market. We illustrate the outcomes we want to achieve in the below causal chain at Diagram 3 (see cost benefit analysis for more detail).

Diagram 3: Causal chain for the proposals



Measuring success

1.12 In line with our commitments in the draft Rule Review Framework, we will collect and monitor data to assess the effects of our proposed rule changes. We propose to make minor additions to the Retail Mediation Activities Return (RMAR) to capture data about the size of PIFs' potential redress liabilities. This will enable us to understand firm compliance with the proposals, the extent of these liabilities and the impact they have on PIFs' capital resources.

1.13 In our 2022 3-year Strategy and our annual Business Plan, we committed to make ourselves more accountable by creating a clear thread from the outcomes we want to achieve for consumers and market participants, to the tools and interventions we use.

1.14 Our proposals are designed to help deliver on 2 of these outcomes

- A reduction in unsuitable advice and an improved consumer redress journey. This will be measured through, over time, fewer upheld Financial Ombudsman Service (the Ombudsman Service) complaints about unsuitable advice or mis-sold products and services (FCA metric CST1-M02)
- A stabilisation and then reduction over time of FSCS compensation, and number of new claims and payments (FCA metric CST1-M02)

Next steps

1.15 Given the importance of getting this right, we will hold an extended consultation period of 16 weeks.

1.16 To test the data we propose to collect, we will also run a pilot data collection for a sample of firms during the consultation period. We will consider the results of this data collection alongside consultation responses before making final rules.

1.17 We welcome feedback on our proposals. Please send us your comments by 20 March 2024.

1.18 We will consider the feedback and aim to publish a Policy Statement, including our response to feedback, in H2 2024. We expect rules to come into force in H1 2025.

Chapter 2

The wider context

Some PIFs are causing significant harm and creating FSCS costs

2.1 Our aim is to ensure that firms that create redress liabilities are better able to pay them. Every redress payment represents a consumer that has suffered harm. This affects consumer confidence and undermines trust in all financial advice firms. A quarter of consumers do not trust that advisers act in the best interest of their clients (FCA Financial Lives Survey 2022).

2.2 We are seeing significant redress liabilities falling to the FSCS. Of the £973m[1] that consumers received in redress between 2016-2022 for pensions and investment-related advice, £757m was covered by the FSCS due to PIFs leaving the market. Behind this £757m are 20,000 consumers who suffered harm. A third of these liabilities (c. £224m) were paid by the FSCS in the 2 years after the firm exited. Some of these liabilities will have been known or knowable to the firm before they left the market.

2.3 FSCS compensation for investment claims is capped at £85,000. In some cases, consumers' losses exceed FSCS limits and these consumers are not fully compensated for their losses.

2.4 This harm is being driven by a small minority of firms, with other firms meeting the cost through the FSCS levy. In a market of approximately 5,000 firms, 75 firms caused 95% of the £757m FSCS costs for PIFs exiting between 2016 and 2022. In addition, only 33% of PIFs have generated an investment or pensions complaint in the last 6 years and only 16% had an unresolved complaint on the 1 January 2023.

2.5 We want to ensure that the firms that generate redress costs are better able to meet them without recourse to the FSCS and that should a firm fail there is more capital for FSCS recoveries. In short, we want the polluter to pay. This is in line with our commitments in the 2021 Consumer Investment Strategy and in response to feedback to our 2020 Consumer Investments Call for Input and our 2022 Compensation Framework Review Discussion Paper.

A broader review of our prudential regime for PIFs

2.6 This consultation includes a wider discussion chapter on the prudential regime for PIFs. See 3.2 for an explanation of what a PIF is.

2.7 In January 2022, we introduced a new, comprehensive prudential regime for MiFID investment firms, which is set out in the MIFIDPRU sourcebook. This regime includes:

1 This excludes FSCS costs for firms that left the market before 2016

a. higher permanent minimum capital requirements of at least £75,000
b. activity-based capital requirements
c. liquidity requirements
d. requirements relating to a new internal capital and risk assessment process (the ICARA process) and
e. wind down planning requirements

2.8 Because PIFs are not MiFID investment firms, they are not subject to the new requirements above. However, PIFs vary in their size and the range of assets they advise on. This means that existing prudential requirements may not be suitable for all PIFs because of the size or the complexity of their operations and do not reflect the consequence of the harm that the regulated activities of some PIFs can cause.

2.9 We are therefore reviewing our prudential regime for PIFs to ensure it remains fit for purpose. This will be a long-term piece of work and will be aligned to the outcomes we aim to achieve through other related workstreams such as the AGBR. We explore this in our section for discussion in Chapter 6.

2.10 Because of the longer-term nature of this broader review and the immediate harm we see, we are now consulting on proposals to require PIFs to be more prudent and set aside capital for potential redress liabilities at an early stage.

2.11 We will review these proposals alongside any further changes we make to the prudential regime for PIFs to ensure the regime is effective, working as intended and supports our commitment to proportionate regulation.

Our proposals in the Consultation Paper

2.12 Where PIFs become aware of potential redress, we want them to quantify and set aside capital resources to cover this at an early stage. Firms that are not able to set aside these resources will have to retain assets, helping them to build up capital and preventing them from depleting their existing capital. This should enable them to meet more of their liabilities.

2.13 We aim to take a proportionate response to minimise the burden on firms and target the firms most likely to cause liabilities. We are introducing a new requirement for all PIFs to quantify potential redress liabilities and report them to us. However, only firms that have identified potential redress liabilities will have to set aside capital and only those that cannot do this will be subject to asset retention requirements. We believe this will result in approximately 750-1550 PIFs having to set aside any extra capital and 40-150 PIFs being required to retain assets (see the cost benefit analysis).

Improving our ability to proactively target PIFs that cause harm

2.14 As noted in the previous section, a small minority of firms are causing harm. Identifying and acting on these firms is a key focus of our ongoing supervision and enforcement

action. We are continually looking to improve our ability to proactively target these firms to prevent this harm.

2.15 Our proposals will help us to act quickly, both reactively and proactively. Our proactive work will use data analytics, for example, through the data we receive on firms' financial positions, potential redress liabilities, complaints and PII, to identify high-risk firms. We will use this alongside the data we get about firms' business models and activities, as well as other information we receive that could suggest risk of harm to consumers, to direct our supervisory focus.

2.16 And whilst our current toolkit allows us to apply asset retention requirements on a firm-by-firm basis where we believe this is necessary to prevent harm, we have limited resources and suffer from information asymmetries when it comes to potential redress liabilities. These proposals would apply asset retention requirements in an objective and consistent way through rules.

Links to related interventions

2.17 Our proposals are closely aligned with the Consumer Duty, which came into force on 31 July 2023 for products and services that are open for sale or renewal. Under the Duty, firms must monitor consumer outcomes and be proactive where they identify they have caused consumer harm, including providing appropriate redress. Complying with the Duty will enable firms to identify potential redress liabilities, and our rules will mean that firms must then quantify these liabilities and set aside capital to meet them. We believe these proposals are needed to bring greater consistency to how PIFs measure and account for their potential redress liabilities to ensure they are able to comply with their Consumer Duty obligations.

2.18 Many PIFs are Principal firms of Appointed Representatives (ARs). We recently wrote to all principal firms to make it clear that they must hold adequate financial resources, taking into account the activities of their ARs. This is consistent with the approach in IPRU-INV 13 (eg IPRU-INV 13.14.8R). Our current proposals will mean that Principal firms will also have to quantify and set aside capital resources for potential redress liabilities for their ARs.

2.19 Our Consumer Investments Strategy set out the outcomes we want for the market and how our work contributes to delivering a market that works well for UK consumers and the businesses that rely on it. A key part of our work is the AGBR which is examining the regulatory boundary between advice and guidance.

2.20 We have published new rules on our regime for Sustainability Disclosure Requirements and investment labels which applies to distributors. We have also announced our plan to establish an industry-led working group in the advice sector, to focus on building advisers' understanding and capabilities regarding advising on products that make claims around sustainability.

How it links to our objectives

2.21 Our proposals advance our 3 operational objectives.

Consumer protection

2.22 Our proposals should help more consumers receive redress directly from firms rather than the FSCS. This will mean they will receive redress earlier and are more likely to be fully compensated (above the £85,000 FSCS cap). Over the period 2016-2022, 16% of the claims paid by the FSCS for PIFs for pension and investment business were at the upper FSCS limit for compensation claims. This suggests that the compensation from some of these claims would have exceeded £85,000.

2.23 In the longer term, we expect that requiring firms to consider the prudential implications of their conduct and to set aside capital to meet any potential redress liabilities, should incentivise them to provide better consumer outcomes in the first place and to resolve harm faster when it does occur. In other words, PIFs will have more 'skin in the game.'

Market integrity

2.24 Our proposals aim to make firms more resilient and better positioned to meet their liabilities when things go wrong. We expect this will result in fewer disorderly failures. Enabling polluter firms to meet more of their liabilities will also have a positive impact on the rest of the market, reducing FSCS compensation costs.

Competition

2.25 In recent years, increasing claims against failed firms have focused attention on the compensation framework within which FSCS operates. Once costs have fallen to FSCS it means the polluter is not paying for the harm they have caused. FSCS compensation costs are funded by levies on firms authorised by the Prudential Regulation Authority and the Financial Conduct Authority. So these costs can represent an extra cost to consumers if they are required to meet them through increased fees for services or products.

2.26 We want to ensure that the FSCS framework helps to maintain confidence in financial services markets and encourages consumers to do business with firms, while not creating conditions which unduly impact competition or create barriers to entry or exit. We expect the cost to consumers from our proposals to be negligible because of competition pressure. In the longer term, we expect that ensuring that the 'polluter' pays redress directly wherever possible will help lower FSCS levy costs for firms that pay into the relevant funding classes (and other classes if the retail pool is triggered) and promote effective competition in the market.

Secondary competitiveness and growth objective

2.27 We expect that these proposals will also advance our secondary competitiveness and growth objective conferred by the Financial Services Act 2023.

2.28 By targeting the firms that create liabilities, we ensure our rules are proportionate. The proposals in this paper support the Government's objective to promote the UK's international competitiveness by enhancing market integrity and contributing to greater levels of trust and confidence in UK markets. This increases the attractiveness of the UK as a place to invest and do business, both within the UK and globally for financial services workers, which can help enable the UK economy's medium to long-term growth and international competitiveness.

2.29 We expect these changes to help increase consumers' trust in the market. Should trust in the market increase, it will encourage take-up of appropriate financial services products, which helps underpin economic growth.

Wider effects of this consultation

2.30 We expect our proposals will lead to approximately 6 – 27 firms exiting the market earlier than they otherwise would have (see the cost benefit analysis), as a result of not being able to reach a sufficient level of capital to meet their potential redress liabilities. This may cause an increase in FSCS compensation costs in the short term. However, where these firms have caused harm in the past, this will prevent them from continuing to build up liabilities.

2.31 We have published a Dear CEO letter alongside this consultation, reminding firms they must not seek to avoid potential redress liabilities. Such behaviour could include changing their corporate structure to isolate liabilities and protect assets (including selling or transferring the client bank), overpaying dividends or allowing the firm to run into insolvency. We are aware of these risks as we exercise our regulatory functions and are monitoring PIFs' capital levels as part of our sector supervision.

2.32 Firms will be particularly interested in the impact our proposals will have on the availability of PII. We know that PII has hardened for advice firms in recent years, both in terms of reduced access and increased prices. We expect that by improving firms' practices and financial risk management, in the longer term this will make it an easier market for PII providers to operate in. We are seeking feedback on our proposals from PII providers as part of the consultation process.

2.33 We have considered whether our proposals could materially reduce consumers' access to advice. We think it is unlikely that a significant number of firms will exit the market, leading to a material reduction in the availability of consumer advice. However, some firms may re-evaluate the products and services they offer. This may make it more difficult for consumers to get some types of advice or may increase the cost, particularly for riskier advice more likely to lead to liabilities. We are taking steps to increase consumer access to the support they need through the joint review of the Advice Guidance Boundary which we are conducting alongside HM Treasury.

Environmental, social & governance considerations

2.34 We have assessed the likely environmental, social and governance impacts of the proposals and have not identified any concerns, but we welcome comments on this issue.

Equality and diversity considerations

2.35 We have considered the equality and diversity issues that may arise from the proposals in this Consultation Paper. Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals during the consultation period and will revisit them when making the final rules. In the meantime, we welcome your input during this consultation on this.

Chapter 3

Our proposals

3.1 We propose to make several changes to Chapter 13 of the Prudential sourcebook for Investment Businesses (IPRU–INV). In summary, these would require PIFs:

- to quantify an amount for their potential redress liabilities
- to set aside capital resources for potential redress liabilities through a new capital deduction, and
- where they have potential redress liabilities and fall below their capital requirements, to comply with an asset retention requirement

Scope of our proposals

3.2 Our proposals would apply to PIFs. A PIF is a firm that mainly provides advice and arranges deals in retail investment products and is exempt from the UK's implementation of the Markets in Financial Instruments Directive (MiFID). PIFs generally rely on the Article 3 MiFID exemption, which means that they are limited in the types of investment services they can provide and cannot hold client money or client assets. There are approximately 5,000 PIFs authorised in the UK today.

3.3 We would require PIFs to quantify and set aside capital resources for potential redress liabilities connected to designated investment business. Designated investment business includes regulated activities like advising on investments, advising on the conversion or transfer of pension benefits and arranging deals in investments. The rules will also apply to ancillary activities that are connected to designated investment business, which is consistent with the general scope of FCA regulatory requirements.

3.4 PIFs that are Principal firms of ARs would be required to quantify and set aside capital resources for potential redress liabilities incurred by their ARs. PIFs would also be required to quantify and set aside capital resources for potential redress liabilities incurred by some other person but for which the firm is liable (for example, under a deed poll).

Q1: Do you agree we should only apply these rules to all activities that are categorised as designated investment business and ancillary activities connected with designated investment business, and for which PIFs are liable?

Exemption for PIFs subject to group supervision

3.5 Some PIFs are part of an investment firm group supervised under the FCA's MIFIDPRU sourcebook (MIFIDPRU), supervised on a consolidated basis in accordance with the

Capital Requirement Regulation (CRR) regime or are part of a group that is subject to group supervision under the Solvency II (SII) regime.

3.6 These groups are, in many cases, required to assess and hold capital for risks to the group as a whole, which may include redress-related risks posed by a PIF in the group. For example, an investment firm group may be required to operate an internal capital adequacy and risk assessment (ICARA) process on a consolidated basis as described in MIFIDPRU 7.9.4G.

3.7 Where such processes exist, we consider that they are capable of delivering equivalent outcomes to the proposals in this consultation. We are therefore proposing to exempt PIFs which are subject to group supervision by the FCA and operate a consolidated ICARA process, and PIFs which are subject to group supervision by the PRA under the CRR or SII and which operate a risk assessment process which achieves equivalent outcomes to a consolidated ICARA process.

3.8 The PIF would have to notify us that it is proposing to make use of this exemption and briefly explain how the group assesses and holds capital for risks posed by the PIF as part of its group assessment.

3.9 This proposal does not prejudice our ability to consult upon further change to the prudential regime for PIFs, including to the way in which risks are assessed at a group level, should we decide this is desirable in pursuit of our operational objectives. Our section for discussion in Chapter 6 explores a broader review of the prudential regime for PIFs.

3.10 We will review the effect of this proposal on the competition dynamics of the market to ensure this does not cause a competitive distortion between PIFs that are part of prudential groups and those that are not. We welcome stakeholder views on the potential competition implications of these proposals.

Q2: Do you agree we should exempt PIFs subject to consolidated supervision under MIFIDPRU or the CRR, or group supervision under SII, and which benefit from group risk assessment? Should PIFs have to notify us that they are proposing to make use of the exemption?

What we mean by potential redress liabilities

3.11 We propose to require PIFs to quantify and set aside capital resources for both 'unresolved redress liabilities' and 'prospective redress liabilities'. Redress may involve a cash payment, or it may involve remediation in another form (eg covering the cost of transferring the consumer into an appropriate alternative product).

3.12 Unresolved redress liabilities refer to instances when a PIF has already received but not resolved a complaint from or on behalf of an eligible complainant, and where this complaint may give rise to a redress liability. This includes any complaints with the PIF, Ombudsman Service and any claims by or on behalf of eligible complainants being brought through the courts.

3.13 **Prospective redress liabilities** refer to instances where a PIF has identified:

- foreseeable harm that could give rise to an obligation to provide redress to a retail customer under PRIN 2A.2.5R, or
- recurring or systemic problems in the course of its complaints handling under DISP 1.3.3R which could give rise to an obligation to provide redress to a customer.

Q3: Do you agree with the scope of potential redress liabilities?

Interaction with general accounting principles

3.14 Our prudential requirements build on general accounting principles, which firms are generally required to use to recognise and measure assets and liabilities.

3.15 General accounting principles normally only require an entity to recognise a provision for an uncertain liability on its balance sheet if it has a probable obligation and can estimate an amount reliably (eg FRS 102 para 21.4). Otherwise, the liability does not appear in a firm's balance sheet in a way that reduces the firm's equity capital.

3.16 However, we do sometimes require firms to take a different approach for the purposes of our prudential requirements to advance our statutory objectives. For example, while general accounting principles may allow firms to attribute value to intangible assets, our rules require firms to deduct the value of any intangible assets when calculating their capital resources.

3.17 We want PIFs to be more prudent than the accounting baseline when it comes to their potential redress liabilities. So our rules would go further by requiring PIFs to recognise and deduct potential redress liabilities from their capital resources earlier than might be required under ordinary accounting principles.

3.18 While our rules supplement the accounting principles around the recognition of liabilities, they do not replace those principles. Once a PIF recognises a potential redress liability in its financial statements in a way that reduces its capital resources, the potential redress liability will cease to count under these rules to avoid double counting.

Identifying potential redress liabilities

3.19 As we have set out in the previous section, potential redress liabilities consist of unresolved redress liabilities and prospective redress liabilities.

3.20 We expect it should be straightforward for a PIF to identify its unresolved redress liabilities, as PIFs are already required to have complaints-handling procedures in place to collect this information.

3.21 Similarly, the Consumer Duty and existing complaints-handling rules already require PIFs to monitor their business, and proactively rectify harm by providing redress in appropriate circumstances. We expect PIFs to use this existing monitoring to identify

prospective redress liabilities. We are not placing a new requirement on PIFs to proactively uncover potential redress liabilities in their past business.

3.22 Identifying a prospective redress liability is not an admission of wrongdoing on the PIF's part, and we will not treat it as such. We view proper identification of prospective redress liabilities as a sensible risk management practice in line with Principle 3 (Management and control) and the requirements in SYSC, which supports a firm in carrying on its business in a sound and prudent manner.

Q4: Do you agree with our proposal not to place new requirements on PIFs to proactively uncover potential redress liabilities in their past business and instead rely on existing monitoring requirements?

Ceasing to identify potential redress liabilities

3.23 We would require PIFs to set aside capital until a potential redress liability has been resolved and there is no realistic prospect of it being reopened. What this means will depend on the nature of the potential redress liability.

3.24 For prospective redress liabilities, we expect that a PIF will have had to investigate the issue and either paid redress or determined redress is not due before it can release the capital.

3.25 For unresolved redress liabilities where a PIF is responding to a complaint, we would expect a PIF that determines no redress is due to wait for 6 months until the referral period to the Ombudsman Service has expired before releasing the capital. In the event that a complaint was referred to the Ombudsman Service, we would expect the PIF to continue holding capital until the Ombudsman Service has made a decision.

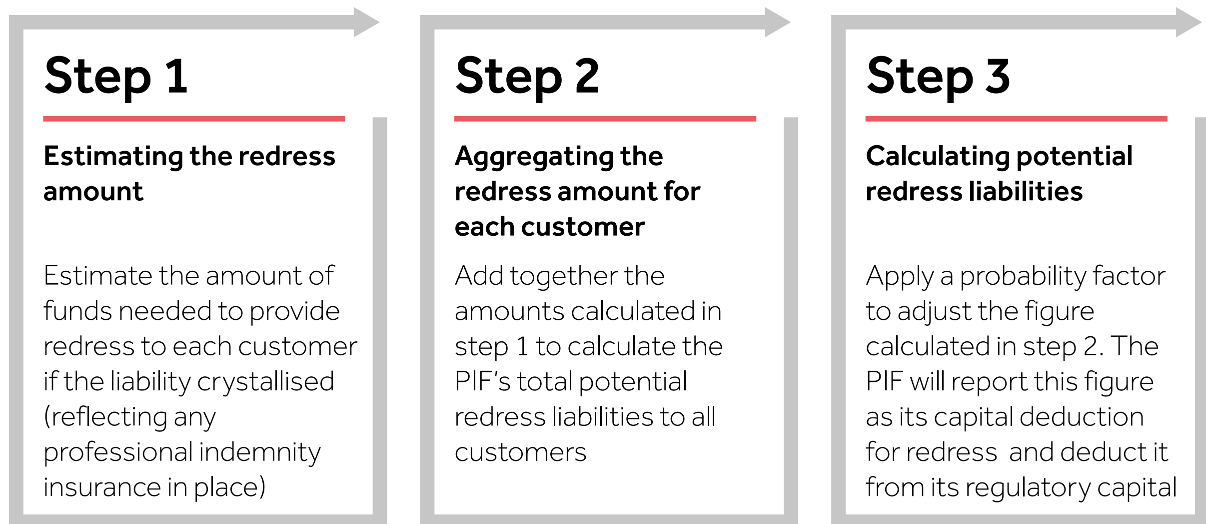
3.26 We do not expect this will generally result in PIFs holding additional capital in the long term or indefinitely. This is because PIFs should already be investigating and resolving potential redress liabilities. And where a PIF determines that it is appropriate to provide redress to resolve the potential redress liability, we would expect it to do so promptly.

Q5: Do you agree with our proposal for PIFs to hold capital resources until a potential redress liability has been resolved and there is no realistic prospect of it being reopened?

Quantifying potential redress liabilities

3.27 Our proposals require PIFs to quantify an amount for all potential redress liabilities they have identified. To do this they will have to complete 3 steps, shown in Diagram 4.

Diagram 4: Summary of the steps to quantify potential redress liabilities



Step 1: Estimating the redress amount for each potential redress liability

3.28 PIFs will be required to make a reasonable estimate of the amount of funds they would need to provide redress to each customer if the liability crystallised.

3.29 As we explain in the next section, PIFs will be able to account for their professional indemnity insurance (PII) cover when estimating an amount for redress. In many cases, this will allow a PIF to use the policy excess as the amount of funds it would need to provide redress if the policy provides adequate cover.

3.30 Otherwise, we expect PIFs to reach a reasonable assumption based on the nature and size of the potential redress liability, taking into account its own knowledge of all relevant circumstances. In doing so PIFs should consider financial loss, and where appropriate pain or suffering, damage to reputation, distress or inconvenience to the customer and the cost of putting that right by providing redress or taking other remedial action. We have published specific guidance for redress on DB transfer advice in DISP App 4.3. The Ombudsman Service has also published guidance on understanding compensation and compensation for investment complaints which may be a useful reference point.

3.31 PIFs should consider any similar complaints that they have resolved in the past, and how the circumstances of those past complaints compare to any potential redress liabilities.

3.32 We have thought about whether it would be appropriate to mandate the redress amounts, either as a single redress figure or a tiered figure. However, redress amounts vary considerably depending on the nature and circumstances giving rise to the redress. And, as redress amounts are also influenced by wider economic circumstances, it would be very difficult to future-proof any figures we included in our rules. Ultimately, we believe a firm is better placed to judge the scale of a potential redress liability, because it knows all the circumstances of the complaint or issue and can better estimate the scale of potential loss. In supervising compliance with these requirements, we would expect PIFs to be able to explain how they have quantified their amounts for potential redress liabilities.

Q6: Do you agree PIFs should estimate the amount of funds they may need to provide redress and we should not mandate a single or tiered redress figure in our rules?

3.33 **Accounting for professional indemnity insurance (PII):** PIFs are required to have appropriate PII or a comparable guarantee which makes provision for any claim for loss or damage, and which cannot be subject to unreasonable limitations or exclusions.

3.34 We therefore propose to allow PIFs to reduce the redress amount per customer in the calculation to reflect the cover the PII policy is likely to provide. However, as PII policies may be subject to terms and conditions, we propose to require PIFs to consider the precise terms of their PII policies (such as any exclusions, limits of indemnity or excesses) to determine whether and by how much it is appropriate to reduce the redress amount.

3.35 We have considered whether it would be appropriate to mandate a maximum PII offset. However, we rejected this approach because:

- A single offset value cannot account for the varied nature of claims and PII policies. As a result, by aggregating we would significantly overstate the value of a PIF's PII cover in some cases and understate it in others.
- We believe mandating a single offset would be unjustified. Many PIFs will have more extensive cover than a single offset would allow and ignoring their more extensive cover would be disproportionate.
- Significant 'information asymmetry' also makes it hard for us to mandate an appropriate single offset. This asymmetry means that PIFs have more information on their policy, the circumstances of the claim and the likelihood of PII covering the claim and are better placed to make this assessment than we are.

Q7: Do you agree we should allow PIFs to reduce the redress amount per customer where PII applies and that we should not mandate a maximum PII offset in our rules?

Q8: Do you have any views on the likely impact of these rules on individual PIFs' PII policies or the PII market as a whole?

Step 2: Aggregating the redress amount for each customer

3.36 Once a PIF has estimated the redress amount for each customer, it should add these together to form its total potential redress liabilities to all customers. For the purposes of reporting, we propose that PIFs record separate figures for their aggregate unresolved redress liabilities and aggregate prospective redress liabilities.

Step 3: Applying the probability factor

3.37 We know not all complaints are upheld and not all prospective redress liabilities that a PIF may initially identify will result in redress. We believe requiring PIFs to hold the full amount of capital for every complaint or issue would be disproportionate. So we propose to allow PIFs to discount the size of their potential redress liabilities to reflect this.

3.38 We propose to prescribe a probability factor using the market wide data we hold on uphold rates for complaints against PIFs. 28% of pensions and investment complaints are upheld. So, we are generally proposing that PIFs have to set aside capital for a minimum of 28% of their total potential redress liabilities.

3.39 To calculate the 28% uphold rate, we analysed complaints data for PIFs between 2020 and 2022. We first calculated separate average uphold rates for (1) pensions and decumulation complaints and (2) investment complaints. The data we hold does not suggest that pensions complaints have a materially different uphold rate to investment complaints – the relevant figures are 28% and 32% respectively. We then calculated a single, weighted uphold rate, taking pensions and investments complaints together, which is 28%.

3.40 We calculated the uphold rates by establishing the individual uphold rate for each PIF that reported any closed complaints during this period, then averaging all PIF values to get a market average for the 3-year period.

3.41 We believe that calculating an individual uphold rate for each PIF, and then averaging these values (weighting all PIFs equally), is more appropriate than simply calculating an average value across all complaints (weighting all complaints equally). Our approach prevents PIFs with high complaints volumes and high uphold rates from distorting the market average.

3.42 We have data on uphold rates from 2016 – 2022. We considered using this longer time period to establish our probability factor. This would have produced a probability factor of 26%. However, uphold rates have generally increased year on year and so we consider it reasonable to use the shorter time period to reflect this. We will review this figure every three years and if there is a material change in uphold rates we will propose changing our rules via a Quarterly Consultation Paper (QCP).

3.43 We know there may be circumstances where a PIF has reasonable grounds to believe that applying a probability factor of 28% discounts one or a group of potential redress liabilities by too much. For example, if it has resolved and upheld a number of similar complaints. In these cases, the PIF must apply a reasonable probability factor that results in less of a discount and the PIF holding more capital. In this way, 28% functions as a minimum probability factor for all PIFs. PIFs would apply this probability factor to their total potential redress liabilities.

3.44 In other circumstances a PIF may have evidence that suggests it should be allowed to apply more of a discount than 28%. We want to give PIFs a mechanism to apply more of a discount in these circumstances. So we are signposting that PIFs may apply to us for a waiver or modification. The process for a waiver or modification is set out in SUP 8.

3.45 We have considered a range of alternatives to this approach:

- Not mandating the probability factor and allowing each PIF to calculate its own figure. However, we are concerned that this would be easy to game, and difficult to supervise. We also recognise that most PIFs are likely to find it challenging, time consuming and disproportionately expensive to calculate their own probability factor. So we consider it is proportionate to invite most PIFs to use a simple 28% assumption.
- We have also considered looking at uphold rates in more detail for different types of complaints or activities. However, we are concerned that this would make the calculation too complex. Given that the data we hold does not suggest material market wide variation in uphold rates across the 2 relevant product groups, we propose to use 1 figure.
- We know there is a large amount of variation in uphold rates among PIFs – 28% is an overestimate for some PIFs but an underestimate for others. For this reason, we propose some flexibility with appropriate safeguards, as we explain above.

Q9: Do you agree we should allow PIFs to reduce their potential redress liabilities by applying a probability factor to both their unresolved and prospective redress liabilities?

Q10: Do you agree we should prescribe the minimum probability factor using our data on uphold rates?

Q11: Do you have any views on how we have reached the probability factor of 0.28?

Setting aside capital resources for potential redress liabilities

3.46 Once PIFs have quantified an overall amount for potential redress in accordance with previous chapters, they would be required to set aside capital resources to cover this. We would require PIFs to deduct their amount for potential redress when they calculate their capital resources. This means they will have to hold sufficient capital resources to meet their potential redress liabilities on top of their minimum capital requirement.

3.47 We already prescribe how PIFs must calculate their capital resources in IPRU-INV 13.15. This includes the existing deductions they must apply. We believe the simplest and most proportionate way to implement this new requirement is to require PIFs to apply an additional capital deduction for potential redress liabilities.

Q12: Do you agree with our approach to deduct potential redress liabilities from PIFs' calculation of their capital resources under IPRU-INV 13.15?

Consequential amendments for PIFs that are also Mortgage and Home Finance Firms or Insurance Intermediaries

3.48 Some PIFs also provide home finance or insurance distribution activities and so are subject to both IPRU-INV 13 and the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU).

3.49 We propose to make some consequential changes for these firms. Currently these firms can calculate their capital resources using the higher of the capital resources counted under MIPRU or IPRU-INV 13. Where firms use the capital resources calculated under MIPRU, they will need to apply the same capital deduction for redress as would be applied under IPRU-INV 13. This is to stop them gaining an unfair advantage over firms only subject to IPRU-INV 13. We have also made a small number of other minor clarifications.

3.50 For clarity, firms subject to MIPRU that are not PIFs (and so not subject to IPRU-INV 13 at all) will not be affected by these changes or any of the other proposals in this CP.

Frequency of the calculation

3.51 PIFs must meet their capital resources requirement at all times (IPRU-INV 13.1.4R). However, the frequency with which we would expect PIFs to repeat the quantification of potential redress liabilities will depend on their circumstances.

3.52 If a PIF has a significant excess of capital resources and has no new information about potential redress liabilities that could be material, it may be sufficient for it to update the quantification of potential redress liabilities as part of its regular financial accounting cycle.

3.53 However, to ensure a PIF complies with its capital resources requirement at all times, it may need to quantify potential redress liabilities outside of its regular financial reporting cycle. It should do this as soon as it becomes aware of new information that could be material to its financial position, such as material new potential redress liabilities, or that its professional indemnity insurance may be materially amended or may not be renewed. PIFs will need to notify us immediately, as required by SUP 15, if they find they are breaching capital requirements between reporting cycles.

Record keeping

3.54 We would expect PIFs to keep records of how they have calculated their amount for potential redress, including details of affected customers, the activity that created the potential redress liability, the redress amount used and the amount offset by their PII. We are not proposing additional record keeping requirements, but remind firms of their existing obligations under SYSC 9 to keep orderly records of their business and internal organisation. These must be sufficient to enable us to monitor the firm's compliance with the requirements under the regulatory system.

Regulatory reporting

3.55 We monitor PIFs' capital through regular financial reporting in the Retail Mediation Activities Return (RMAR) every 3 or 6 months, with the PIF's size determining the schedule of returns. We want to build the new deduction into the RMA-D1 form so that we can monitor how PIFs are complying with the new requirements and proactively identify PIFs that may be calculating or reporting incorrectly.

3.56 Reporting this capital deduction via RMAR will enable us to know whether a PIF has fallen below its minimum capital resources after it has set aside capital for its potential redress liabilities. In these circumstances a PIF would become subject to an asset retention requirement (see the section below on applying and lifting asset retention requirements).

3.57 We also want to add a small number of additional fields to provide greater detail on how PIFs are calculating the capital deduction for redress. This will enable us to supervise compliance with the requirements:

1. For unresolved redress liabilities:
   a. Value of all unresolved redress liabilities (£)
   b. Number of customers impacted
2. For prospective redress liabilities:
   a. Value of all prospective redress liabilities (£)
   b. Number of customers impacted
3. Whether PII insurance has been used to offset figures at 1a or 2a (Y/N)
4. How much has been offset (£)

3.58 To test this data collection, we plan to run a pilot data collection during the consultation period. The aim of this will be to test firms' experience with completing the new fields to examine whether firms understand the questions and can answer them robustly. The aim is not to collect information on PIFs' potential redress liabilities for supervisory use. We will consider the results of the pilot data collection alongside consultation responses before making final rules.

Q13: Do you agree with our proposal to implement the deduction via a change to PIFs' regular financial reporting in the Retail Mediation Activities Return (RMAR)? If not, please say why and what alternatives you think are appropriate.

Alternative options for regulatory reporting

3.59 We know that PIFs already undertake significant regular reporting. We believe that minor changes to existing reporting processes are the most proportionate way for us to get information about how PIFs are implementing the new capital deduction. However, we would welcome firms' views on whether they would find ad-hoc reporting more proportionate and cost effective.

3.60 Another option would be to implement the reporting initially via ad-hoc reporting and incorporate it into the regular financial reporting in the Retail Mediation Activities Return (RMAR) later. This would, for example, allow us to look at the quality of data we are getting and improve associated guidance notes. However, it would mean PIFs have to carry out multiple sets of reporting in the shorter term.

Q14: Do you have any views on the alternative of implementing this reporting via ad-hoc reporting?

Applying and lifting an asset retention requirement

3.61 We propose that any PIF that has potential redress liabilities and is below its minimum capital requirements after it has applied the deduction for redress to its capital resources, will be subject to an asset retention requirement.

3.62 We also propose that an asset retention requirement should apply where a PIF is below its minimum capital requirements and has provisioned for redress liabilities on its financial statement in line with relevant accounting standards. We want PIFs to hold sufficient capital to meet their potential redress liabilities and any redress liabilities provisioned for in their financial statements. This would also prevent firms from gaining an advantage under these proposals by provisioning for redress liabilities in their financial statements.

3.63 The purpose of the asset retention requirement is to:

- help ensure that a PIF increases its capital resources to the level it must hold to comply with its minimum capital resources requirement
- maximise a PIF's ability to pay for potential redress liabilities
- preserve assets by preventing PIFs from undertaking transactions outside the ordinary course of business
- facilitate an orderly wind down where a PIF fails to meet its crystallised redress liabilities

3.64 The asset retention requirement would apply until the PIF can demonstrate that it has sufficient capital resources (after applying the deduction for redress) to meet its minimum regulatory capital requirements.

3.65 To ensure transparency, we intend to publish information about which PIFs are subject to an asset retention requirement on our Financial Services (FS) Register. We expect that the transparency benefits of this, both to the market and consumers, outweigh the costs in terms of reputational risks to the firm. We also expect that publishing the asset retentions will give PIFs an incentive to increase their capital to meet their capital requirements and lift the asset retention requirement.

Q15: Do you agree that we should impose an asset retention requirement on PIFs that do not have sufficient capital resources (after applying the deduction for redress) to meet their minimum regulatory capital requirements?

Q16: Do you agree that this should include circumstances where a PIF is not meeting its minimum capital requirements and has provisioned for redress liabilities in its financial statements?

Q17: Do you agree with our proposal to publish information about which PIFs are subject to an asset retention requirement on the FS register?

Excluded firms

3.66 We propose to limit the scope of our asset retention rules by excluding specific types of firms for which an asset retention requirement would not be necessary or appropriate, in addition to the general exclusion for PIFs subject to group supervision (see paragraph 3.5).

3.67 The types of firms we propose to exclude are:

- Firms that are natural persons (ie sole traders) or unlimited partnerships involving one or more natural persons. As there is no clear legal division between the personal assets of sole traders or partners and business assets of such firms, we do not consider it appropriate to impose an asset retention requirement on these firms through these rules.
- Firms that are subject to an insolvency order or a Creditor's Voluntary Liquidation under Chapter IV of Part IV of the Insolvency Act 1986. These rules are, in part, designed to reduce the risk that firms fail, and to maximise the availability of their assets if they fail. But the rules are not intended to prevent a firm's assets being paid out if it does fail.

- Firms already subject to individual asset retention requirements with a similar effect to the proposed asset retention requirements. Where these asset retention requirements already exist, it is not necessary to replicate their effect through rules.

3.68 While the firms in paragraph 3.67 will be excluded from the proposed asset retention rules, they will still be subject to the other proposals in this consultation, including the proposed reporting requirements. This is because we still want to ensure that these firms use prudent financial risk management and are able to meet any liabilities that arise. We would still expect excluded firms to notify us where they are unable to meet their potential redress liabilities and we will decide whether we need to take further action, for example by imposing bespoke asset retention requirements.

Q18: Do you agree with the proposed exclusions to the asset retention requirement?

Diagram 5: How the asset retention requirement rules work

Application and notification

- The asset retention requirement applies when a PIF has potential redress liabilities (or has provisioned for redress liabilities) and is below its minimum capital requirement (after applying the deduction for redress to its capital resources).
- It takes effect as soon as the PIF identifies that it is below its minimum capital requirements.
- The PIF must notify us of the capital breach immediately. This should be done through the RMAR, or via the form at Sup-15 Annex 4 if this can't be done immediately.

Next steps

- We will communicate with the PIF to request a remediation plan, which we would generally expect to receive within 10 business days of our request.
- While the asset retention requirement applies, the PIF will be prevented from undertaking transactions outside the ordinary course of business (see Diagram 6 below).

Lifting the requirement

- To lift the asset retention requirement, a PIF must notify us that it has sufficient capital to meet its minimum capital requirements after deducting any remaining potential redress liabilities (or redress liabilities provisioned for). The notification

must be made through RMAR, unless this would delay the notification, in which case it should be made via the form at Sup-15 Annex 4.
- When a PIF notifies us that it is meeting its capital requirements, we have 20-business days to request further information or notify the PIF that we do not agree with its assessment. If we request more information, we will have a further 20 business days following receipt of this information.
- Unless we have asked for more information or notified the PIF that we do not agree with its assessment, the requirement automatically ceases to apply 20 business days after the PIF's notification.

Application and requirement to notify

3.69 We have considered at what point the asset retention requirement should begin, and how and when a PIF should notify us that they are in capital breach. We propose that the asset retention requirement should take effect immediately, as soon as a PIF with potential redress liabilities identifies that it is below its minimum capital requirements. This means that the asset retention requirement applies with immediate effect regardless of any notification to or confirmation from us. In line with firms' existing record-keeping obligations set out at paragraph 3.54 above, we would expect firms to keep orderly and sufficient records and be able to demonstrate when they identified the capital breach.

3.70 Where a PIF fails to comply with its regulatory requirements and does not properly identify that it should be complying with the asset retention requirement, and this has caused the PIF to be unable or less able to provide redress, we may act to fine or recover appropriate amounts from the SMF managers or other individuals concerned.

3.71 While the asset retention requirement would take effect immediately, the PIF would still need to notify us of the regulatory capital breach. In line with SUP 15.3.1R, it should notify us immediately. A PIF can do this in 2 ways:

- through the RMAR, where this can be done immediately
- or through the form in SUP 15 Annex 4, where notification through the RMAR cannot be done immediately.

Q19: Do you agree with the proposed methods for the application of the asset retention requirement and the proposed notification requirements?

Remediation plan

3.72 After a PIF notifies us of a regulatory capital breach under these rules, we will generally expect it to submit a remediation plan. We will ask the PIF for this, and we would expect to receive the remediation plan within 10 business days of our request.

3.73 The following are examples of information and documents we may request as part of the remediation plan: the source of the PIF's potential redress liabilities, the reason for the regulatory capital breach and plan for remediation, timeframe to remedy the breach, and/or business plan and wind down plan.

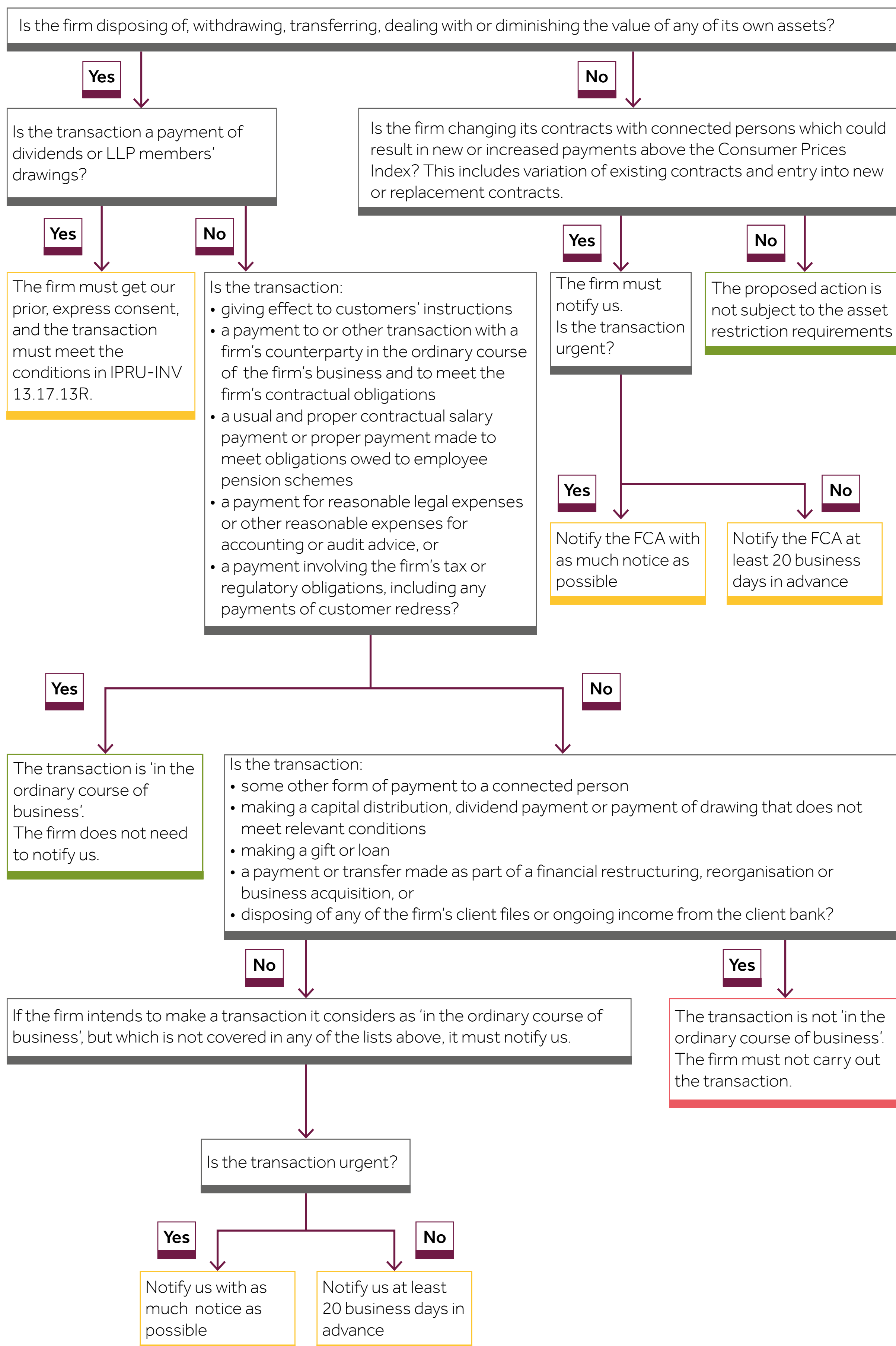
3.74 We will expect PIFs to comply with their existing obligations to resolve complaints at the earliest possible opportunity and, where they identify foreseeable harm, to investigate the circumstances and assess what remedial action or redress may be appropriate.

Q20: Do you agree with our proposals for the remediation plan?

Effect of the asset retention requirement

3.75 Where it applies, the asset retention requirement would prevent a PIF from undertaking transactions that are not 'in the ordinary course of business'. We propose to make rules and guidance about what amounts to the 'ordinary course of business'. Where a PIF wants to carry out transactions that they consider to be 'in the ordinary course of business' but which are not listed as such in the rules, it will have to notify us in advance or obtain our prior consent.

Diagram 6: Asset retention requirement – transactions in the 'ordinary course of business'



Transactions in the ordinary course of business

3.76 We propose that PIFs treat the following transactions as occurring in the ordinary course of business:

- transactions giving effect to customers' instructions
- payments to or other transactions with a firm's counterparties in the ordinary course of the firm's business and to meet the firm's contractual obligations
- usual and proper contractual salary payments and proper payments to meet obligations owed to employee pension schemes
- payments for reasonable legal expenses and other reasonable expenses for accounting or audit advice
- payments involving the firm's tax or regulatory obligations, including any payments of customer redress

3.77 This means that a PIF may carry out any of these transactions even if it is subject to an asset retention requirement. This list is not comprehensive. However, if a firm intends to make a transaction that it considers is in the ordinary course of business but is not on this list, it will have to notify us at least 20 business days before making the transaction. If the situation is urgent, the 20-business day period will not apply but the firm must give as much advance notice as possible. Our proposal to require notifications at least 20 business days in advance is an increase on the 15 business days in our British Steel Consumer Redress Scheme Rules. This is to allow us more time to properly assess these notifications and seek any further information from firms.

3.78 If a PIF proposes to enter new or amended contracts with a connected person which may result in new or increased payments above the Consumer Price Index rate of inflation, the firm will also be required to notify us, within the same timelines as the notifications referred to 3.77.

3.79 PIFs should make these notifications through the form in SUP 15 Annex 4. These notifications must contain specified information to show that the transaction is in the ordinary course of business.

Payment of dividends and LLP members' drawings

3.80 The asset retention requirement would generally prohibit a PIF from paying dividends or LLP members' drawings, because these transactions reduce the funds a firm has available to pay redress.

3.81 However, we recognise that some PIFs may use dividends or limited liability partnership (LLP) members' drawings as a way of remunerating natural persons for services they provide to the firm, in a way that is similar to an ordinary salary. We do not intend to ban this practice, if it occurs in the ordinary course of business.

3.82 There is a high risk that dividends or LLP members' drawings may be used in a way that dissipates assets. So we propose that firms get our consent before paying out any dividends or LLP members' drawings. Firms will have to provide specified information as

part of any application, to show that the transaction is in the ordinary course of business, is otherwise lawful, and financial forecasts which show the effect of the proposed dividends or drawings on the firm's regulatory capital position over time.

3.83 Dividends or drawings which allow a firm to increase its regulatory capital over time, and which support the firm in setting aside resources for potential redress liabilities over a reasonable time horizon, would support compliance with a firm's wider regulatory obligations under the threshold conditions or principles for business.

Transactions not in the ordinary course of business

3.84 We propose that PIFs treat any of the following transactions as not occurring in the ordinary course of business:

- payments to any connected person, except where these fall in the list of permitted transactions in paragraph 3.76 or under the 'Payment of dividends and LLP members' drawings' section
- making of any capital distributions, dividend payments or payment of drawings, unless permitted under the 'Payment of dividends and LLP members' drawings' section
- making of any gift or loan
- any payments or transfers made as part of any financial restructuring, reorganisation or business acquisition
- disposing of any of the firm's client files or ongoing income from the client bank

3.85 If an asset retention requirement applies to a PIF, the PIF may not carry out any of these transactions.

Q21: Do you agree with our proposed rules for transactions in or outside the ordinary course of business?

Q22: Do you agree with our proposal to require PIFs to notify us at least 20 business days in advance (or with as much advance notice as possible in urgent situations) for transactions that they consider to be in the ordinary course of business but which are not listed in our rules, and for new or amended contracts with a connected person which may result in new or increased payments above the Consumer Price Index rate of inflation?

Lifting the asset retention requirement

3.86 The asset retention requirement will be lifted when a PIF can demonstrate that it is no longer in regulatory capital breach, ie that it has sufficient capital resources (after applying the deduction for redress) to meet the capital resource requirement in

IPRU-INV 13.13. We expect PIFs would do this by injecting capital, naturally increasing capital by retaining profit, or reducing potential redress liabilities (by investigating any issues and providing redress where appropriate).

3.87 While the asset retention requirement applies with immediate effect, we do not think it should be lifted without supervisory oversight. We have considered whether it would be appropriate to approve every asset retention requirement that is lifted, to prevent PIFs incorrectly deciding that they are no longer in breach of their minimum capital requirements and removing assets that may be needed for redress.

3.88 In practice, we see potential problems with this approach. We do not want to unreasonably delay or restrict a PIF's ability to transact or deal in its assets.

3.89 We propose that PIFs will have to notify us once they are meeting their minimum capital requirements, and they should be able to provide evidence if we request it. To give firms certainty and give us the opportunity to engage with firms, we believe it is proportionate for the asset retention requirement to be automatically lifted 20 business days after this notification. However, if within 20 business days we request further information or inform the firm that we do not agree it is meeting its minimum capital resources requirement, the asset retention requirement would not cease to apply.

3.90 If we request further information, the 20-day period will restart after the PIF provides this information.

3.91 This should give us enough time to review most notifications and decide whether we are satisfied with the asset retention requirement being lifted, or request further information where necessary.

Q23: Do you agree with our proposals for lifting the asset retention requirement?

Our supervisory approach

3.92 We are also proposing new guidance on how we intend to supervise these proposals, at IPRU-INV 13.18. This includes how we intend to use the information we receive to inform our supervisory approach, including further supervisory action we consider necessary to supplement our proposals.

3.93 This guidance also reminds SMF managers that they are personally accountable for the breach of the conduct rules in COCON. It also explains that where a firm has failed to comply with regulatory requirements and that failure has led to the firm being unable or less able to pay redress, we may take action to fine or recover appropriate amounts from SMF managers or other individuals concerned.

Chapter 4

Implementation period

4.1 We aim to publish a Policy Statement in H2 2024, and for the rules to come into force in H1 2025. We propose that there should be at least a 6-month period between the publication of the Policy Statement and the rules coming into force to allow PIFs time to prepare for this.

4.2 To further help PIFs and align compliance with our proposals with firms' financial reporting, PIFs will only be required to quantify and report their potential redress liabilities, and (where appropriate) comply with the asset retention requirement, for the purposes of their first RMAR submission the rules come into force. This will stagger implementation of the rules over the 6 months following the date they enter into force.

Q24: Do you agree with our proposed implementation period?

Chapter 5

Firm journey examples

5.1 We outline below the journey for 2 example firms. At each stage of the process, we illustrate how the remedy would work for these 2 firms.

5.2 Firm journey for Firm A – a small adviser, with good PII cover and no past complaints:

Identifying potential redress liabilities (existing regulatory requirement)	Firm A has no unresolved complaints so no unresolved redress liabilities. During a customer's annual review, the firm becomes aware that it gave a personal recommendation without fully considering the customer's circumstances. The firm identifies that the customer may have suffered harm as a result and the firm may have a redress liability.
Quantifying and reporting potential redress liabilities	**Estimating the redress amount:** The firm proactively looks at its back book and sees this is a one-off error. Firm A knows 1 customer is affected. The firm notifies its insurer who confirms the claim is likely to be covered by its PII policy. It quantifies the redress amount as the excess under its policy (£5,000) **Aggregating the redress amount for each customer:** Only 1 customer is affected so the firm calculates its aggregate potential redress amount as £5,000 **Calculating and reporting potential redress amounts:** The firm applies the 0.28 probability factor reducing the amount to £1,400 while it investigates the circumstances in accordance with PRIN 2A.10.2R. In its next RMAR cycle, Firm A reports the £1,400 as an additional deduction to its capital resources.
Applying and lifting an asset retention requirement	Firm A has eligible capital of £40,000 and a minimum capital requirement of £20,000, giving it a £20,000 capital surplus. Firm A's capital surplus is reduced to £18,600 after the deduction for its potential redress liabilities. As Firm A remains in capital surplus, it is not subject to an asset retention requirement.

5.3 Firm journey for Firm B – an adviser that specialises in pension advice, with good PII cover and a moderate complaints history.

Identifying potential redress liabilities (existing regulatory requirement)	Firm B has 2 unresolved complaints for DB pension transfer advice provided by 1 adviser. During its annual review it identifies there may be a pattern of non-compliance by that adviser, which could have led to other cases of unsuitable advice. The firm has identified that the same adviser has advised on 20 other DB cases.
Quantifying and reporting potential redress liabilities	**Estimating the redress amount:** Firm B has had a similar complaint upheld by the Ombudsman Service and was ordered to pay £20,000. The complaints will not be covered by the firm's PII policy as they fall within a specific exclusion. The firm uses the Ombudsman Service settlement as a starting basis for estimating the redress amount. But it also considers the circumstances of each potential redress liability to make an estimate of the amount of redress per customer. **Aggregating the redress amount for each customer:** There are 22 customers affected and the aggregate redress is £500,000 **Calculating and reporting potential redress amounts:** The firm has observed a general uphold rate of 40% for its historic complaints, and therefore considers that it would be reasonable to use this as its probability factor rather than 0.28, reducing the amount to £200,000. In its next RMAR cycle Firm B reports the £200,000 as an additional deduction to its capital resources.
Applying and lifting an asset retention requirement	Firm B has eligible capital of £70,000 and a minimum capital requirement of £20,000, giving it a £50,000 capital surplus. Once Firm B deducts its potential redress liabilities it has a £150,000 deficit. Firm B is therefore subject to the asset retention requirement and notifies us accordingly. After being contacted by us, Firm B submits a remediation plan showing that it plans to remedy the shortfall by retaining profits. The firm investigates the potential redress liabilities and holds capital until these are resolved and there is no realistic prospect of them being reopened. The firm subsequently reaches a surplus through retaining profits. Some potential redress liabilities have been paid out proactively in accordance with the Consumer Duty. In other circumstances the firm has concluded that advice was suitable or that there was no loss and explained this to the relevant customers. The firm notifies us that it is now in capital surplus and we have 20 working days to request further information or tell the firm we disagree, otherwise the asset retention requirement is lifted automatically. We are satisfied with the firm's progress and the asset retention requirement is lifted.

Chapter 6

Discussion Chapter – Reviewing prudential requirements for PIFs

Why we are publishing this Discussion Chapter

6.1 The earlier chapters set out our proposals to require PIFs to be more prudent and set aside capital for potential redress liabilities at an early stage. Our aim is to ensure that firms that create redress liabilities are better able to pay them.

6.2 However, we know there is more to prudential regulation than setting aside capital to meet redress liabilities. Prudential regulation is also about ensuring that a firm understands the risks it is running, and about driving the right behaviour by aligning the incentives between a firm, its customers and other stakeholders.

6.3 Our existing prudential requirements for PIFs, set out in Diagram 2, combine minimum capital requirements and the requirement to hold appropriate professional indemnity cover. PIFs are currently not subject to specific liquidity requirements. At present, their capital resources requirements are based on their income, without reflecting the scale of assets that they give advice on, specific risks that they face or their activities.

6.4 We are concerned that existing prudential requirements may not be suitable for all PIFs due to the size or complexity of their operations and do not fully reflect the consequence of the harm that firms can cause through their regulated activities. We cannot stop some of the firms that are under FCA oversight from failing as we are not, nor should we be, a zero-failure regulator. The proposals in this consultation are a first step towards improving the prudential regime for PIFs. However, we think more can be done to prevent a situation such as the one described in Chapter 2 where a small number of PIFs can cause significant harm relative to their size and activities undertaken.

6.5 We are considering moving towards a more comprehensive prudential regime for PIFs, drawing on our experience from introducing the Investment Firms Prudential Regime (IFPR) in January 2022. The IFPR aimed to streamline and simplify the prudential requirements for MiFID investment firms we prudentially regulate.

6.6 We believe that a comprehensive prudential framework should generally include a combination of the following elements:

- regulatory rules around capital and liquidity adequacy
- risk management, governance and credit and loss provisioning requirements so firms consider the level of resources they should have
- wind down planning requirements
- professional indemnity insurance
- reporting and disclosure requirements

6.7 In the following sections we explore each of these elements and seek input from respondents to inform our review. The intention is to take a proportionate and risk-based approach to prudentially regulating PIFs. We want to focus on the firms and activities with the greatest potential to harm consumers, or those which harm the integrity of the UK financial system. We would specifically welcome views on the proportionality of these elements.

Q25: Do you agree that we should consider moving towards a more comprehensive prudential regime for PIFs? Have we identified the correct elements?

Capital requirements

6.8 Firms have minimum capital requirements to help ensure that they have resources available to run a business on a day-to-day basis and to meet any unexpected costs.

6.9 Having adequate capital helps align firms' incentives with the best interests of their clients and wider markets by ensuring they have 'skin in the game'. Many PIFs choose to hold significantly more capital (see Diagram 7) than their minimum regulatory requirement (£20,000 or if higher 5-10% of a firm's annual income from investment business).

Diagram 7: Capital surplus across the market on 31st December 2022

Adviser firm Income Band	Total number of adviser firms in that Income Band	Capital Surplus			
		<£20k	Between £20k and £60k	Between £60k and £100k	Over £100k
< £200k	1664	44%	29%	9%	18%
£200k to £600k	1707	18%	24%	16%	42%
Over £600k	1676	7%	9%	8%	76%
Total	5047	23%	21%	11%	45%

6.10 PIFs may hold surplus capital for reasons unrelated to their regulatory requirements, including to manage risk, cash-flow or tax liabilities. However, there are no specific requirements preventing owners from removing this excess capital at their own discretion.

6.11 Despite the increase in capital requirements for PIFs in 2016 and our guidance in FG20/1, the requirements for PIFs remain low (£20,000 or if higher, 5-10% of a firm's annual investment business income) relative to other types of regulated firm (eg £75,000 for MIFID investment advisers and £150,000, £750,000 or £4m for other types of MIFID investment firms).

Minimum levels of capital resources

6.12 Although PIFs mainly advise on and arrange investments, which map to MiFID investment services, PIFs generally rely upon the Article 3 MiFID exemption. As PIFs are not MiFID investment firms, they are not subject to the IFPR.

6.13 On the other hand, firms formerly known as Exempt Capital Adequacy Directive (exempt CAD) firms (also called arranger/adviser firms) are subject to the IFPR. This is because they carry out MIFID investment services and do not rely upon the Article 3 MiFID exemption. These firms have a Permanent Minimum Requirement of £75,000. Transitional arrangements in the IFPR mean that former exempt-CAD firms can opt to gradually increase their Permanent Minimum Capital from £50,000 in 2022 to reach the final requirement of £75,000 in 2027.

6.14 In effect, despite PIFs and former exempt-CAD firms carrying out similar activities, PIFs have lower capital requirements than former exempt CAD firms. As mentioned, our analysis of regulatory returns indicates that most PIFs hold more capital than required by our rules. An increase to £55,000 to match the current requirements in IFPR would require only about half of firms to raise their capital.

6.15 It is important that firms hold enough capital to incentivise them to operate in a sustainable and viable manner where they can meet their obligations. However, given that a small number of firms generate the vast majority of claims as noted earlier, there should be a proportionate balance between how much capital firms are required to have and the likelihood of the harm they would cause.

Q26: Are there any reasons PIFs should have significantly lower minimum capital requirements than other firms carrying out broadly similar activities?

Activity-based capital requirements

6.16 PIFs provide a range of services for a range of investments. Some of these are more straightforward than others and so less likely to lead to redress claims. Other activities are riskier and have historically led to large redress claims. Between 2012 and 2022 83% of PIF FSCS costs were caused by advice on self-invested personal pensions (SIPPs) or pension transfers.

6.17 The size of PIFs and the scale of their activities varies, ranging from very small firms with a few advisers to large network firms. Current capital requirements are not calibrated to consider the investments advised on or the size of the firm to determine minimum capital requirements.

6.18 Differentiating requirements for firms by the type of advice it provides could discourage some advisers from providing certain advice as an unintended consequence or lead to more PII exemptions if a certain type of advice is identified as being likely to cause claims. Where requirements are based on specific advice given, this may be a backward-looking measure and address risks that have already materialised but would not address new risks.

6.19 It can also be difficult to base capital requirements on the size of the PIF and the scale of their activity alone. Firms with relatively small balance sheets can cause harm several times their size due to the nature of the advice given. Similarly, an income-based requirement, such as the current one for some PIFs does not fully consider the risk of the advice given.

> **Q27:** **Should there be additional capital requirements based on the activities (type and scale) a PIF undertakes? If yes, how could these requirements be calibrated to account for the most harmful activity?**

Liquidity requirements

6.20 Holding capital enables a firm to pay liabilities if they arise, but the capital must be in a realisable form. If a firm's capital surplus is tied up in illiquid assets, there may not be enough cash to cover redress liabilities or to wind down the firm in an orderly fashion when they are not earning any revenue. Stressed circumstances could result in increased outflows and increase risks of mismatched cash flows.

6.21 Good quality liquid resources are those that firms can convert into 'cash' when needed and with minimum loss in value under adverse circumstances. The availability of liquid resources means consumer complaints can be dealt with quicker and with more certainty about how much will be recovered, improving outcomes for consumers.

Basic liquid assets requirements

6.22 Liquidity requirements aim to help ensure that firms have some resilience to sudden shocks that place constraints on its cashflow. This should help ensure they can continue to function or otherwise exit the market without disruption, by continuing to fund their overheads for a given period and without having to rely upon ongoing revenue. Consumers with an ongoing relationship with a firm may value continuity of service rather than having to seek a new provider. Where a firm must cease trading, an orderly wind down gives consumers time to seek alternative providers.

6.23 In determining the quality of liquid resources a firm has, we consider:

- ability to monetize liquid assets
- diversification of liquid resources
- currency convertibility
- transferability of funds

6.24 Firms must hold the right proportion of different types of resources. This should include a minimum 'basic' amount of liquid resources that every firm must have to ensure that it has adequate liquid resources.

Q28: Should PIFs be required to hold a minimum amount of liquid resources? If yes, how would we determine an appropriate amount?

Activity based liquidity requirements

6.25 As well as a basic liquid asset requirement, we could require firms that provide higher risk advice to hold additional liquid assets, reflecting the higher likelihood of having to provide redress when things go wrong.

6.26 Basing liquidity requirements on a firm's activities can help us target our interventions at the activities most likely to cause harm and create a proportionate regime, given that we know that a small number of firms generate the vast majority of redress claims.

Q29: Should some activities require PIFs to have higher liquidity requirements? If yes, how could we calibrate the requirements to reflect the risk of the activities undertaken?

Improved risk management requirements

6.27 Principle 4 of our Handbook requires firms to maintain adequate financial resources. A firm must also have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to. Firms must also have internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information-processing systems (SYSC 4.1.1).

6.28 A sound risk management and controls framework allows firms and their senior management to identify, understand, manage, monitor and mitigate the risk of potential harm to consumers and markets. The quality of prudential management is currently inconsistent between firms. Clearer standards, backed by rules may be desirable to achieve greater consistency in the market and improve standards.

Establishing a process for assessing and managing risks

6.29 Under the IFPR, firms are required to carry out an internal capital and risk assessment (ICARA). This is a continuous internal review process meant to support the firm's management body in the decision-making process and their exercise of oversight and control over the firm.

6.30 Firms must have processes in place to assess the amount and type of own funds and liquid assets (financial resources) they should hold to cover the type and amount of risk they might pose to others, or which they themselves face. These processes should be appropriate and proportionate to the nature, size and complexity of the firm's activities.

6.31 There is no equivalent process for PIFs. We could follow the approach in the IFPR and require firms to carry out a form of internal capital and risk assessment. We could set out the framework to carry out this assessment to support consistent standards. The proposals in this consultation will require PIFs to quantify an amount for their potential redress liabilities and set aside capital resources for them. This is a specific instance where PIFs need more capital than the regulatory minimum requires. Going beyond this, we would want PIFs to undertake a broader assessment of their future capital needs, of which potential redress liabilities are one aspect, and set aside sufficient capital.

Q30: Are current risk management requirements sufficient? Would specific processes help PIFs improve their assessment of risks and capital needs?

Wind down planning

6.32 Firms subject to the IFPR require a wind down plan, but we do not require the same for PIFs. While we have published a wind down planning guide to show what an effective wind down plan might include, many smaller PIFs do not have a wind down plan or hold enough capital to cover wind down costs.

6.33 Wind down planning aims to reduce the impact of a firm's failure, for example, through its inability to provide redress or a service interruption. Credible and realistic wind down plans consider the circumstances and reasons a firm's management would decide to wind down a business and how different scenarios would affect the resources available to wind down a firm.

6.34 As a part of wind down planning firms can do a qualitative assessment that considers the operational tasks necessary to wind down the firm, such as identifying key systems and staff dependencies with essential third parties.

6.35 Firms can also carry out a quantitative assessment, considering the amount of time it would take to wind down the business, the amount of capital required and any additional wind down costs that may materialise. Firms should consider the nature, amount and timing of necessary outflows and the quality and availability of liquid resources.

Q31: Can wind down plans help reduce the risk of disorderly failure of a PIF? If yes, what aspects of wind down planning are most relevant?

Professional indemnity insurance

6.36 PIFs are required to have PII or a comparable guarantee which covers all a firm's past business since authorisation, as well as business to be conducted while the policy is in force. This helps PIFs access additional resources to pay for liabilities caused by professional negligence, errors or omissions.

6.37 PII is an important part of a firm's risk management framework and complements other parts of our prudential framework. Insurers help firms improve the way they run their business by offering risk management advice, providing additional monitoring and sharing best practice. This encourages the right behaviour from firms and helps increase standards.

6.38 In some limited circumstances, a PIF may find it difficult to get PII cover due to the activities it undertakes or its past conduct. As an alternative approach, we could consider allowing PIFs in these circumstances to hold materially higher levels of capital or a 'ring-fenced' amount of core liquid assets equivalent to the corresponding aggregate limit of indemnity under a PII policy with automatic reinstatements. This would ensure that PIFs that cannot access PII have adequate resources to settle any valid claims brought against them. We previously allowed this. However, we ended this approach in 2005 when the Insurance Mediation Directive (which applied to the majority of PIFs) introduced mandatory PII.

> **Q32:** **How can the use of PII be improved to help complement our other prudential requirements to reduce the risks and harms that can arise through firms' regulated activities?**

Reporting requirements

6.39 Useable and reliable data helps us identify areas where harm is building up and allows us to take action before it escalates.

6.40 Firms are required to submit information to us that enables our supervisors to assess the financial health of a firm. We recognise that PIFs have significant regular reporting. This provides us with crucial data on the firm's capital, the quality of its PII, its revenue and how far this revenue is derived from DB transfer advice or through advising on non-standard investments.

6.41 However, the risks of harm may be heightened if firms are under significant pressure for financial performance or on the verge of failure. Understanding a firm's financial vulnerabilities and proximity to failure is important to minimise its impact should this occur. We want to explore where additional reporting would enable us to identify vulnerable PIFs and better supervise this market.

6.42 We also expect that the data reported would also be useful to PIFs. It could inform the metrics a PIF uses as part of its own risk management and help identify vulnerabilities. Reporting should not be seen as purely a compliance process.

> **Q33: Do you agree that data is an important part of a comprehensive prudential framework? Are there specific metrics firms or the FCA should be looking at?**

Next steps

6.43 We welcome input to the elements we are exploring in this chapter. Please send us your comments by 20 March 2024.

6.44 The input we receive will help shape our future policy thinking for a holistic review of the prudential regime for PIFs. We will consider the proposals set out in the earlier chapters of this publication alongside feedback from stakeholders when proposing any further changes to the prudential regime for PIFs to ensure the regime is effective, working as intended and supports our commitment to proportionate regulation. We will provide an update on next steps in due course.

Annex 1

Questions in this paper

Consultation Paper

Q1: **Do you agree we should only apply these rules to all activities that are categorised as designated investment business and ancillary activities connected with designated investment business, and for which PIFs are liable?**

Q2: **Do you agree we should exempt PIFs subject to consolidated supervision under MIFIDPRU or the CRR, or group supervision under SII, and which benefit from group risk assessment? Should PIFs have to notify us that they are proposing to make use of the exemption?**

Q3: **Do you agree with the scope of potential redress liabilities?**

Q4: **Do you agree with our proposal not to place new requirements on PIFs to proactively uncover potential redress liabilities in their past business and instead rely on existing monitoring requirements?**

Q5: **Do you agree with our proposal for PIFs to hold capital resources until a potential redress liability has been resolved and there is no realistic prospect of it being reopened?**

Q6: **Do you agree PIFs should estimate the amount of funds they may need to provide redress and we should not mandate a single or tiered redress figure in our rules?**

Q7: **Do you agree we should allow PIFs to reduce the redress amount per customer where PII applies and that we should not mandate a maximum PII offset in our rules?**

Q8: **Do you have any views on the likely impact of these rules on individual PIFs' PII policies or the PII market as a whole?**

Q9: **Do you agree we should allow PIFs to reduce their potential redress liabilities by applying a probability factor to both their unresolved and prospective redress liabilities?**

Q10: Do you agree we should prescribe the minimum probability factor using our data on uphold rates?

Q11: Do you have any views on how we have reached the probability factor of 0.28?

Q12: Do you agree with our approach to deduct potential redress liabilities from PIFs' calculation of their capital resources under IPRU-INV 13.15?

Q13: Do you agree with our proposal to implement the deduction via a change to PIFs' regular financial reporting in the Retail Mediation Activities Return (RMAR)? If not, please say why and what alternatives you think are appropriate.

Q14: Do you have any views on the alternative of implementing this reporting via ad-hoc reporting?

Q15: Do you agree that we should impose an asset retention requirement on PIFs that do not have sufficient capital resources (after applying the deduction for redress) to meet their minimum regulatory capital requirements?

Q16: Do you agree that this should include circumstances where a PIF is not meeting its minimum capital requirements and has provisioned for liabilities in its financial statements?

Q17: Do you agree with our proposal to publish information about which PIFs are subject to an asset retention requirement on the FS register?

Q18: Do you agree with the proposed exclusions to the asset retention requirement?

Q19: Do you agree with the proposed methods for the application of the asset retention requirement and the proposed notification requirements?

Q20: Do you agree with our proposals for the remediation plan?

Q21: Do you agree with our proposed rules for transactions in or outside the ordinary course of business?

Q22: Do you agree with our proposal to require PIFs to notify us at least 20 business days in advance (or with as much advance notice as possible in urgent situations) for transactions that they consider to be in the ordinary course of business but which are not listed in our rules, and for new or amended contracts with a connected person which may result in new or increased payments above the Consumer Price Index rate of inflation?

Q23: **Do you agree with our proposals for lifting the asset retention requirement?**

Q24: **Do you agree with our proposed implementation period?**

Discussion Chapter

Q25: **Do you agree that we should consider moving towards a more comprehensive prudential regime for PIFs? Have we identified the correct elements?**

Q26: **Are there any reasons PIFs should have significantly lower minimum capital requirements than other firms carrying out broadly similar activities?**

Q27: **Should there be additional capital requirements based on the activities (type and scale) a PIF undertakes? If yes, how could these requirements be calibrated to account for the most harmful activity?**

Q28: **Should PIFs be required to hold a minimum amount of liquid resources? If yes, how would we determine an appropriate amount?**

Q29: **Should some activities require PIFs to have higher liquidity requirements? If yes, how could we calibrate the requirements to reflect the risk of the activities undertaken?**

Q30: **Are current risk management requirements sufficient? Would specific processes help PIFs improve their assessment of risks and capital needs?**

Q31: **Can wind down plans help reduce the risk of disorderly failure of a PIF? If yes, what aspects of wind down planning are most relevant?**

Q32: **How can the use of PII be improved to help complement our other prudential requirements to mitigate against the risks and harms that can arise through firms' regulated activities?**

Q33: **Do you agree that data is an important part of a comprehensive prudential framework? Are there specific metrics firms or the FCA should be looking at?**

Cost benefit analysis

Q34: Do you have any views on the cost benefit analysis, including our analysis of costs and benefits to consumers, firms and the market?

Q35: Do you have any views on whether there are costs specific to small firms that need to be captured further in the cost benefit analysis?

Annex 2

Cost benefit analysis

Introduction

1. When making rules, the FCA has a duty to consult and produce a cost benefit analysis (CBA) under the Financial Services and Markets Act 2000 (FSMA). Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'.

2. This CBA annex presents estimates of the significant impacts of our proposal. We provide monetary estimates for the costs and benefits where we believe it is reasonably practicable to do so. Where they cannot be reasonably estimated, we provide an explanation of the FCA's opinion and estimates of outcomes. Our proposals are based on carefully weighing up these multiple dimensions and reaching a judgement about the appropriate level of consumer protection, taking into account all the other impacts we foresee. Our CBA also takes account of the new secondary competitiveness and growth objective, where relevant and appropriate, when assessing the benefits and costs of rules proposals.

High-level description of the sector

3. According to the Financial Lives Survey 2022 (FLS 2022), 28% of all individuals surveyed have received regulated financial advice over the last 5 years. Of these, 58% received advice on investments, 37% on pension accumulation, and 46% on pension decumulation. One third of these individuals reported investible assets of £100,000 or higher, and two thirds were 55 years old or older.

4. Much of this advice will have been provided by personal investment firms (PIFs). A PIF is a firm that mainly provides advice and arranges deals in retail investment products and is exempt from the UK's implementation of the Markets in Financial Instruments Directive (MiFID). PIFs generally rely upon the Article 3 MiFID exemption, which means that they are limited in the types of investment services they can provide and cannot hold client money or client assets. As a category, "PIFs" include most investment advisers and many retail investment intermediaries, and exclude any firm that is categorised as a "MiFID investment firm" under the FCA's rules. Some PIFs also offer mortgage and insurance advice (ie hold more than one permission), but the focus of this CP and CBA is on their investment business.

5. Based on Retail Mediation Activities Return (RMAR) section D1 and our data on firm cancellations, as of 2 October 2023 there were 4,939 PIFs ('firms') that will be affected by our proposed rules (see below), excluding PIFs that are part of a group which is subject to supervision at group level. In practice not all of these will operate group risk assessment

processes and so not all will be exempt from our proposals (see paragraph 3.5-3.10 of the CP). But this is our best estimate of the number of firms in scope.

6. These firms are not homogenous and vary by size. According to PIFs' annual FCA fee blocks which allocate firms a ranking based on their position within groups of firms with the same fee block (annual income, modified eligible liabilities, gross premium income, etc.), we have identified 1 large firm; 23 medium firms; and 4,915 small firms. Since 2017, on average 288 new PIFs enter the market annually and around 258 exit.

7. According to our analysis of firms' Retail Mediation Activities Returns sections B and K, PIFs offered financial advice to approximately 5 million consumers in 2022 either on an ongoing (3.9 million) or on a one-off (1.1 million) basis and had a gross revenue from their retail investment permissions of £722 million during the same year.

8. As we set out below, some PIFs have historically been the source of significant misconduct leading to consumer harm and significant redress liabilities, which is why PIFs are the focus of this intervention. This annex considers the costs and benefits of our proposals to address this harm which include a requirement for PIFs to set aside capital for their potential redress liabilities at an early stage.

Problem and rationale for intervention

The harm

9. Misconduct by PIFs can lead to consumer harm. Examples of this harm include, but are not limited to, reduced financial returns or losses due to the purchase of unsuitable products, and the subsequent stress, anxiety and loss of time in resolving the issue (see FLS 2022).

10. Under our existing rules, firms may need to provide redress for harm incurred following a complaint from a customer (DISP 1.4). Firms must also monitor complaints and consumer outcomes to identify recurring or systemic problems, and identify and rectify foreseeable harm, proactively offering redress where appropriate (DISP 1.3 and PRIN 2A.9). Where firms fail to do so (eg due to misidentifying foreseeable harm or wilfully seeking to avoid their liabilities) this causes harm to consumers in a number of ways.

11. Delays in identifying and rectifying recurring, systemic or foreseeable issues may result in consumer harm continuing for a longer period or even increasing as more consumers experience the same harm. Consumers may suffer harm in terms of stress and anxiety while their claim is being processed.

12. In cases where the firm that has caused consumer harm and the associated redress liability has exited the market, consumers have to rely on the Financial Services Compensation Scheme (FSCS) for redress. Data from the FSCS and complaints data from PIFs show that consumers received £973m in redress between 2016-2022 for pensions and investment-related advice (excluding PIFs that left the market before this). Of this, only 22% (£216 million) was paid by the PIFs whose misconduct caused this harm, and the remaining 78% (£757 million) was covered by the FSCS with most falling

on the Life Distribution & Investment Intermediation (LDII) funding class (ie caused by firms leaving the market but covered by the firms remaining in the market). Of these claims resulting in FSCS payments, more than 98% were due to unsuitable advice. The total harm caused could be larger given there are some consumers who have not yet sought redress and some who may never seek it from either the PIFs or the FSCS. The total harm caused could be larger given there are some consumers who have not yet sought redress and some who may never seek it from either the PIFs or the FSCS.

13. Redress paid by the FSCS is currently capped at £85,000 for firms which failed on or after 1 April 2019. This means where redress exceeds £85,000 and the firm has left the market, the consumer will be unable to be compensated for the full amount of harm suffered. Over the period 2016-2022, 16% of the claims paid by the FSCS for PIFs for pension and investment business were at the upper limit for compensation claims at the FSCS. This suggests that the compensation from some of these claims would have exceeded £85,000 if the cap was not in place and that these consumers were not fully compensated for the harm they experienced.

14. As well as the direct harm suffered by consumers from firm misconduct, ultimately, misconduct and the lack of prompt redress may erode customer trust in the sector. FLS 2022 found trust to be a barrier to seeking advice for some adults who had not had advice but might have a need for support, as 43% of respondents disagreed that financial advisers are unbiased and 26% did not trust them to act in the best interests of their clients. This suggests that there may be a lack of market participation resulting from lack of confidence, potentially caused by firm misconduct.

15. There is also a cost imposed by firms engaging in misconduct to the wider industry. Firms that generate redress liabilities due to misconduct and that are subsequently unable to cover these liabilities will exit the market. The presence of the FSCS means that consumers will still be able to recover these liabilities up to the £85,000 cap. This is made possible due to the industry-wide FSCS levy. However, this means that firms that continue to operate in the sector and did not engage in the misconduct ('non-polluters') will end up bearing the cost of these liabilities rather than the firms that generated them ('polluters') and exited the market. If the polluters cover their own redress liabilities, the resources of non-polluters can be used for other purposes, such as improving the value of their own services.

16. Finally, as we discuss in more detail in the following section, where firms fail to rectify harm in a timely manner, this can give rise to moral hazard issues that limit the firms' incentives to improve their conduct going forward.

Drivers of harm

17. Under the existing rules, summarised in paragraph 1.9 of the CP, firms are required to act to rectify any foreseeable harm they detect during their regular monitoring or complaints handling, including paying redress where appropriate. However, a lack of clear prudential rules which require firms to quantify and set aside capital for potential redress liabilities at an early stage may be leading to harm.

18. Under basic accounting principles, a PIF is generally only required to recognise a provision for an uncertain liability on its balance sheet if it has an obligation which is probable (ie more likely than not) and the amount can be estimated reliably (eg FRS 102 para 21.4). This means that firms may hold just enough capital to comply with their minimum capital requirements, but not enough to cover their potential redress liabilities.

19. As firms are not clearly required to hold capital to meet their potential redress liabilities, they may prefer to use these funds in other ways that benefit shareholders or other stakeholders more, such as for paying out dividends or bonuses. This reduces the firms' incentive to use the funds to proactively rectify any foreseeable harm they may have caused or to put the funds aside to be used if and when any redress liabilities they have caused crystallise.

20. Additionally, when firms hold capital below the level required to cover their potential redress liabilities, this results in moral hazard. Moral hazard emerges in situations where an economic agent displays risky behaviour because they are protected against the potential negative outcomes. In the context of the PIF sector, firm owners/shareholders know that if the firm's potential redress liabilities exceed its available capital and it is forced to exit the market, they may not be held liable for any remaining liabilities that the firm cannot meet. The presence of this moral hazard limits firms' incentives to reduce the risk of generating redress liabilities in the first place by improving their conduct: firms (or their owners) do not have sufficient 'skin-in-the-game' to improve conduct.

21. Finally, informational asymmetries and behavioural biases may limit the ability of consumers to recognise where quality of service may have been below standard and where they may be able to claim redress. This reduces the incentive of firms to provide a fair service to customers in the first place, as well as to take remediating action and offer redress where necessary in a timely and proactive manner.

Our intervention

The proposed rules

22. Below we set out our proposed rules and our expectations on how these will address the harms outlined above. We provide more details on our proposed rules in Chapter 3 and a summary in paragraph 1.9 of the CP.

23. Our proposals require PIFs to use their existing regulatory monitoring controls to identify and quantify their *'potential redress liabilities'*, deduct their value from their regulatory capital and to report this deduction to us as part of their RMAR-D1 submission every 3 or 6 months (depending on the PIF's size). The potential redress liabilities refer to the total of unresolved and prospective redress. Our proposals do not apply to PIFs that are part of a group which assesses risk and is subject to prudential supervision at group level (see paragraph 3.5-3.10 of the CP).

24. When quantifying their potential redress liabilities, firms would account for the professional indemnity insurance (PII) that they hold, and they would also apply a probability factor. Paragraphs 3.33 to 3.35 of the CP describe how firms would account

for their PII cover. Paragraphs 3.37 to 3.45 describe how firms would calculate the probability factor and how they would apply it. The probability factor accounts for the fact that not all complaints are upheld and not all prospective redress liabilities that a firm may initially identify will result in redress.

25. With the deduction of their potential redress liabilities, firms would be required to set aside capital in addition to their current regulatory capital requirements to cover their potential redress liabilities. The additional capital would reflect each firm's estimate of the amount of capital that would be needed to meet its potential redress liabilities.

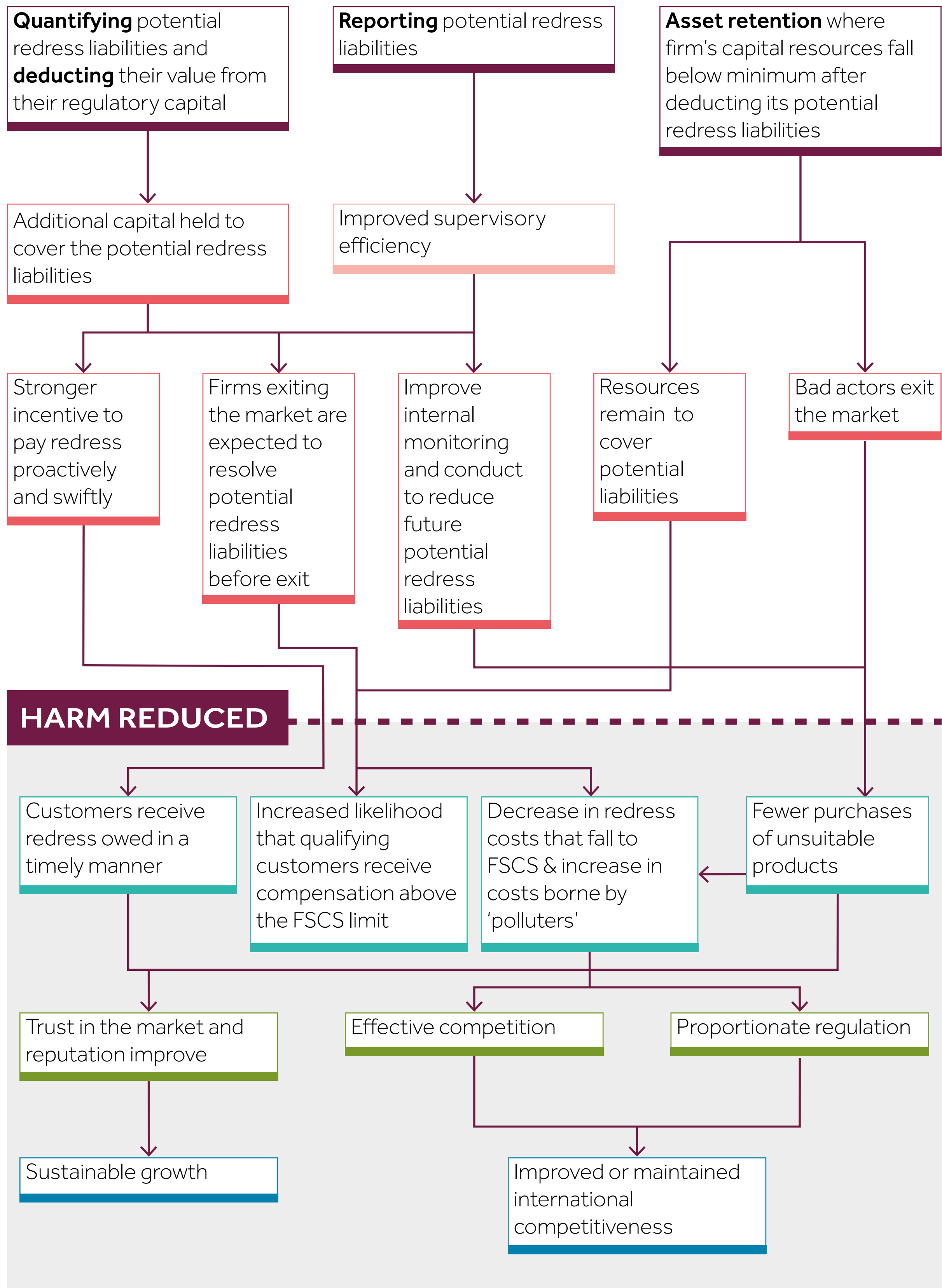
26. Where firms do not hold sufficient capital to meet their capital requirements (after the deduction for redress), they will be subject to an asset retention requirement until the capital requirements are met. A firm subject to an asset retention requirement will be prevented from undertaking transactions not 'in the ordinary course of business', such as distributing dividends (details are provided in paragraphs 3.75-3.85).

27. In line with existing expectations in SUP 6.4 we will expect firms that apply to cancel their authorisation to provide a reasonable way to discharge the complaints against them, any unsettled or unexpired liabilities, and investigate any matters that could result in potential redress liabilities.

Causal chain

28. The following figure illustrates how we expect the proposed regulatory change to improve consumer, firm and market outcomes.

Figure 1: Causal chain



Other options considered

29. Following good practice, we have considered several alternatives before arriving at our preferred proposal. In this section, we set out these alternatives and our justification for not selecting them as our preferred approach.

'Do nothing' (Delivering through the Consumer Duty)

30. The new Consumer Duty is designed as a system-wide intervention to improve consumer outcomes across several different markets. It sets higher and clearer standards of consumer protection across financial services and requires firms to act to deliver good outcomes for customers. In this instance, we believe these proposals are needed to improve our ability to supervise and enforce against the Duty, and to bring greater consistency to how PIFs measure and account for their potential redress liabilities to deliver good customer and market outcomes. Our proposals reinforce the requirement under the Consumer Duty for firms to be more proactive in remediating foreseeable harm and in providing redress where appropriate by targeting the drivers of harm that we have identified above.

'Alternative option 1' (Uniform increase in capital requirements)

31. Rather than a change to capital requirements based on firms' individual complaints status, we considered increasing the minimum capital requirement uniformly across all PIFs to account for any potential redress liabilities these firms may incur. This approach would limit the amount of redress liabilities falling on the FSCS and increase the likelihood that qualifying customers receive full redress owed. However, it would not link the capital requirements to the firms' potential redress liabilities. As a result, it would not incentivise firms to provide more suitable services in order to minimise these liabilities in the future. Further, a uniform increase in capital requirements means that firms without potential redress liabilities – firms not responsible for the harms under consideration – would also have to incur costs to raise capital. As we note in the Discussion Chapter (Chapter 6 of this consultation), there should be a proportionate balance between how much capital firms are required to have and the likelihood of the harm they would cause.

'Alternative option 2' (Targeted supervision of firms with potential redress liabilities)

32. We have also considered a more targeted supervisory intervention that would identify firms whose conduct has historically created harm in the market ('polluters') and to require them to hold assets for potential redress. The benefit of such an approach would, in theory, be lower costs on non-polluters.

33. However, in practice, cost savings to non-polluters from such an approach are likely to be minimal. Identification of polluters would require market-wide data collection and a targeted past business review to attempt to identify those firms with redress liabilities. Such a review would be expected to take time, require firms (both polluters and non-polluters) to incur significant costs (for example we estimated the costs for

each file review in CP22/6 to be £1,000) and would have to be repeated frequently as the circumstances of individual firms change over time.

34. Further, there is a risk that such an approach may, to some extent, misidentify polluters and non-polluters, placing disproportionate burden on some firms over others and potentially distorting competition.

Our analytical approach

35. We analyse the impacts of our proposed policy against a baseline, or 'counterfactual' scenario, which describes what we expect will happen in the market in the absence of our proposed interventions. That is, we compare a 'future' under the policy, with an alternative 'future' without the policy.

Baseline

36. Here we set out the counterfactual for what we expect would have happened in the absence of a policy intervention over a 10-year appraisal period. In this baseline, the Consumer Duty is the main mechanism to incentivise firms to reduce harm.

37. We expect that the types of harm we described in the relevant section of the CBA (paragraphs 9 to 16) will largely continue to persist without our intervention. Briefly, these harms are:

- Consumer harm (eg psychological) due to reduced likelihood of foreseeable harm being proactively remediated
- Polluters could avoid their potential redress liabilities by exiting the market, with these being covered by the FSCS
- Increased likelihood that where firms exit the market, a proportion of consumers would have uncompensated losses
- Consumers continuing to purchase unsuitable products

38. We expect that the introduction of the Consumer Duty may alleviate the harm we have identified to a certain extent. Because the Duty was only recently introduced, we are currently unable to assess and forecast how it will affect the evolution of the harm we have identified. However, as we describe in paragraph 28 of the CBA, we expect that our proposals to require firms to identify and report foreseeable harm will improve our ability to supervise and enforce against the Consumer Duty.

Key assumptions

39. Our analysis makes several assumptions:

- Unless stated otherwise, all references to 'average' are the mean average
- All price estimates are in nominal terms
- When estimating net present value (PV) of costs and benefits, we use a 3.5% discount rate as per the Treasury's Green Book
- All firms will fully comply with the rules we implement and alter their behaviour to minimise their potential redress liabilities and ultimately deliver the outcomes our proposals seek to achieve

- The core business model of firms in this sector will remain unchanged
- Consumer behaviour will remain unchanged
- Wider market conditions (consumers' need for advice, level of competition) will remain unchanged
- Firm's regulatory returns have been filled out correctly and the data provided is accurate.

40. To estimate the impact of our proposals at the point of implementation, we conduct an Impact Assessment which is presented in paragraphs 47 to 79 of this CBA alongside the relevant assumptions.

Summary of costs and benefits

41. The following table summarises the costs and benefits of the proposed intervention in current prices.

Table 1: Summary of costs and benefits

Stakeholder	One-off/ ongoing	Costs	Benefits
Firms	One-off	Familiarisation & gap analysis, £2.8 million	• Reduction in FSCS bill • Increase in confidence and participation
	One-off	Training, £1.4 million	
	One-off	IT project change, negligible	
	One-off	Change project, negligible	
	Total one-off	**Aggregate, £4.2 million**	
	Ongoing	Familiarisation & gap analysis, -	
	Ongoing	Training, -	
	Ongoing	IT project change, £0.1 million *per annum*	
	Ongoing	Change project, £5.4 million *per annum*	
	Ongoing	Opportunity cost of capital, *unable to quantify*	
	Total ongoing	**Aggregate, £5.5 million *per annum***	

Stakeholder	One-off/ ongoing	Costs	Benefits
Consumers	One-off & ongoing	Pass-on costs arising from familiarisation, training and change, negligible	• Decrease in purchases of unsuitable products (avoided harm from unsuitable products) • Consumers are proactively and more quickly offered redress • Compensation above FSCS limit
	One-off	Switching costs to a new provider, negligible	
FSCS	One-off	Unmet potential redress liabilities, negligible	
	One-off	Resources for increase in claims, negligible ('business-as-usual')	
FCA	One-off	Changes to systems and data capabilities, £0.4 million	• Improved supervisory efficiency
	One-off	Supporting internal authorisations processes, £0.1 million	
	Total one-off	**Aggregate, £0.5 million**	
	Ongoing	Resources for supervision and authorisations, negligible ('business-as-usual')	

Note: Some figures do not add up because of rounding errors.

42. We estimate the equivalent annualised compliance cost to be equal to £6.0 million per annum.

43. Because we are unable to reasonably quantify the benefits of our proposed intervention – something not uncommon with prudential rules – we have assessed the value the benefits would need to reach in order for our proposals to break-even. We estimate that for our proposed rules to break-even, they would need to reduce FSCS costs by an amount equal to 5.6% of their average annual value during the 10-year period after the proposals are implemented, all other things being equal. We provide further details of our break-even analysis in the relevant section of the CBA (paragraphs 119 to 124).

44. Below we discuss in more detail our cost and benefits estimates, as well as the impact assessment analysis that informed them.

45. We discuss the limitations of our analysis in the Risks and Uncertainty section of the CBA (paragraphs 125 to 131).

Per firm compliance costs

46. On Table 2 we set out the costs per firm. We estimate that the cost of our proposals per firm is small relative to their size. In particular, for small size firms we estimate the compliance cost to be low, £1,000 on a one-off basis and £1,000 on an ongoing basis, on average.

Table 2: Per firm compliance costs

Size of firm	Average one-off cost per firm	Average ongoing cost per firm
Large	£10,000	£40,000
Medium	£3,000	£9,000
Small	£1,000	£1,000

Note: Costs estimates rounded to the nearest '000.

Impact assessment

47. To inform our estimates of costs and benefits we have undertaken a detailed impact assessment analysis that estimates:

- the number of firms that will report potential redress liabilities,
- which firms will need an asset retention requirement,
- the number of firms that will exit the market as soon as our proposals come into effect because they do not or cannot raise capital to meet their potential redress liabilities, and
- the potential redress liabilities they would leave on the FSCS following their exit.

48. The output from this impact assessment is then used to estimate costs of the intervention.

Methodology

49. Our estimates use data on past complaints, complaint uphold rates, and average redress at the firm level from 2017 to 2022 to estimate firms' potential redress liabilities at the point of the proposed intervention coming into effect. Due to unavailability of data on firms' prospective redress liabilities, we use past complaints as a proxy for prospective liabilities. We set out the rationale for this below.

50. We use the formula ***Potential redress liabilities = I * A * P***, for pension and investments separately and for each PIF separately.

51. *I* is the estimated number of consumers impacted. It is equal to the number of unresolved complaints in the complaints data plus the number of estimated prospective claims (also referred to as ***prospective redress liabilities*** in this CBA). We estimate prospective claims to be equal to the total number of complaints opened against a firm in the preceding 6 years (2017-2022).

52. Our complaints data indicate that PIFs with ***no complaints*** for six years have a very low ex-post probability of receiving complaints in the following two years, 6% for investment related complaints and 8% for pensions. PIFs that have ***at least one complaint*** in the last six years have a much higher ex-post probability of receiving further complaints in the following two years, 37% for investment related complaints and 45% for pensions. We considered including these probabilities in our model to weight firms' prospective redress liabilities, but our results would not be materially impacted. This is because the estimates we would obtain after applying this weight would fall within the interval of values that we have using the existing scenarios for the prospective liabilities.

53. ***A*** is the estimated redress amount and is equal to the firm-specific average of redress paid by a firm per upheld complaint, ie the total redress amount divided by the number of upheld complaints. We observe a number of firms that have had complaints opened in the past but for whom none of the complaints were upheld. This was the case for 629 firms that had zero upheld investment related complaints and 853 firms with zero upheld pension related complaints, out of the 4,939 total firms in scope. For these firms, we assume that the average redress amount is equal to the sector wide average redress per upheld complaint. These figures are £8,933 for investments related complaints and £11,273 for pensions related complaints.

54. ***P*** is the estimated probability factor which we use to discount the potential redress liabilities that a firm initially identifies. We apply this discount factor in recognition of the fact that not all potential redress liabilities have a 100% probability of resulting in redress. ***P*** is equal to the firm-specific ratio of total upheld complaints to total opened complaints. Where this value is lower than 28% or missing, we use a minimum probability factor of 28%. The minimum probability factor we apply is informed by our proposals. We note that a minimum probability factor below 28% would reduce the value of the estimated potential redress liabilities, while one higher than 28% would increase their value.

55. We consider the impact of the proposed rules under three different scenarios where we vary the amount of *prospective* redress liabilities that firms can accurately identify. We weigh the volume of prospective liabilities that are accurately identified by 0%, 50% (central scenario) and 100% in each scenario, ie in the central scenario we say that half of prospective liabilities are accurately identified by firms. We use these scenarios to account for the fact that we do not have data that allows us to estimate the number of prospective redress liabilities that firms will be able to identify. In contrast, unresolved redress liabilities are observable at the firm level because the complaint exists and is reported to us, so we do not weigh or adjust them.

56. We assume that firms would be able to use their full PII to cover their potential redress liabilities and would only need to set aside the policy excess for each claim plus the value of potential redress liabilities that exceeds the aggregate limit of indemnity of their policy. Firms report their PII policies in their RMAR section E (RMAR-E). Where firms have multiple excess values within a policy, we use the policy's maximum excess. Where firms have multiple policies, we sum up the aggregate limits of indemnity and use the maximum excess across all policies. Where the average redress owed by a firm is below the firm's policy excess, we assume that firm will not use the PII cover. PII contracts often contain an aggregation clause that allows a number of similar or linked claims to

be treated as a single claim with a single excess, but we do not account for it as we are unable to observe it.

57. To estimate the total excess that firms would need to put in their potential redress liabilities, we apply the 28% probability factor to the number of complaints in order to estimate the number of claims each firm will make and multiply the estimated number of PII claims with the excess.

58. We recognise that using PII cover may not always be possible in practice, so we tested what the results look like without any PII cover. Although we see some differences in the number of firms affected and the capital they will have to put aside for their prospective liabilities, the findings do not differ significantly compared to the full PII cover scenarios.

59. Firms would be subject to asset retention requirements if their potential redress liabilities exceeded their regulatory capital excess as reported in RMAR-D1.

60. We expect firms would exit the market when the difference between their potential redress liabilities and their current capital excess exceeds twice their average annual profit reported in RMAR section B during the period 2017-2022, because it is unlikely that they would be able to raise sufficient capital or retain sufficient profits to meet their potential redress liabilities.

61. For the firms that would exit, their entire potential redress liabilities (unresolved plus 100% of their prospective redress liabilities) exceeding their total regulatory capital would be covered by the FSCS, up to the £85,000 cap per customer.

62. For the firms with an asset retention requirement that would not exit the market, we assume that they would inject additional capital or retain their profits to cover the capital shortfall.

63. We have exempted all PIFs that are part of a group which is subject to supervision at group level. In practice not all of these will assess risks at group level so not all will be exempt from our proposals. We have also exempted from the asset retention rules PIFs whose legal status is either 'sole trader' or 'unlimited partnerships'.

Results

64. The table below summarises the results of the impact assessment for firms that we estimate will remain in the market, with three scenarios for the proportion of prospective redress liabilities identified, assuming full PII cover and no PII cover. In our central scenario (50% identification of prospective redress liabilities, full PII cover) we estimate that our proposed rules will directly affect 1,635 PIFs of the 4,939 PIFs covered by the proposals, that identify and quantify an amount of potential redress liabilities. In the scenario where no firms are able to identify any prospective redress liabilities (0% identification), 775 PIFs will identify and quantify an amount for known current unresolved redress liabilities (768 assuming no PII cover).

Table 3: Impact assessment results for PIFs in scope

Identi-fication scenarios	PII cover scenarios	Number of PIFs with potential redress liabilities without asset retention	Value of *identified* potential redress liabilities of PIFs without asset retention	Number of PIFs with asset retention remaining in the market	Value of *identified* potential redress liabilities of PIFs under asset retention remaining in the market	Number of PIFs that will exit	Value of *identified* potential redress liabilities of PIFs that will exit	Value of *total identifiable* (unresolved plus 100% of their prospective redress liabilities) potential redress liabilities of PIFs that will exit	Value of total potential redress liabilities covered by the PIFs that exit (impact of asset retention)	Impact on FSCS: *Total* potential redress liabilities exceeding total capital resources of PIFs exiting	Firms remaining in the sector
100%	Full cover	1,511	£31.5 million	104	£5.2 million	20	£7 million	£7 million	£5.9 million	£1 million	4,919
	No cover	1,487	£37.8 million	121	£7.8 million	27	£11.2 million	£11.2 million	£6.8 million	£4.4 million	4,912
50%	Full cover (*)	1,548	£20.4 million	74	£4.1 million	13	£0.6 million	£1.1 million	£0.6 million	£0.5 million	4,926
	No cover	1,528	£22.6 million	91	£6.5 million	16	£4 million	£7.2 million	£3.9 million	£3.3 million	4,923
0%	Full cover	775	£5.8 million	33	£0.8 million	6	£0.1 million	£0.4 million	£0.1 million	£0.3 million	4,933
	No cover	768	£6 million	40	£3.2 million	6	£0.2 million	£0.5 million	£0.1 million	£0.4 million	4,933

Note: There are 4,939 PIFs in scope, and in total we estimate 1,635 PIFs will be affected by the rules. The number of PIFs with potential redress liabilities without asset retention is higher in the 50% scenario because less firms are subject to asset retention. In the scenario with 0% compliance, firms will not identify their prospective liabilities and will only report the unresolved ones, which decreases the number of firms that will be affected by the rules. There are 29 PIFs with missing capital related data points for 2022 in RAMR section D1, out of which 11 had estimated potential redress liabilities in total of £90,000 under 100% scenario. (*) indicates our central scenario. In the central scenario, there are 7 PIFs that are sole traders or unlimited partnerships and estimated to have a capital shortfall. For the scenarios with 50% and 0% identification, we assume that the impact on FSCS will be from all of the firms' identifiable potential liabilities and not only from the proportion that they identify. For the firms that exit, we assume that their entire regulatory capital will be used to cover their potential redress liabilities (see paragraph 61 of the CBA).

65. Our central scenario is where firms identify 50% of the prospective redress liabilities and can use their full PII cover to address them. In practice individual firms may identify a large or a smaller amount of prospective liabilities, but we consider the 0% or 100% identification scenarios to be highly unlikely.

66. For the firms that we estimate will remain in the market in our central scenario, they will hold capital equivalent to £24.5 (£20.4+£4.1) million to cover their potential redress liabilities. This capital would be used to proactively cover potential redress liabilities. Of these firms, 74 will need an asset retention requirement that will enable to build up capital to their potential redress liabilities.

67. For our central scenario we estimate that 13 firms will exit leaving less than £1 million of potential redress liabilities on the FSCS. We estimate that the maximum impact on the FSCS (scenario of 100%; no PII cover) will be from 27 PIFs exiting that would leave £4.4 million out of the total £11.2 million that we estimate they will have in potential redress liabilities. This means that we estimate that they will be able to cover £6.8 million of their potential redress liabilities through the proposed asset retention requirements.

68. In our central scenario we estimate that the firms that would exit would have £1.1 million in potential redress liabilities but would only have identified £0.6 million due to the assumption of 50% identification. These firms would be unlikely to be able to cover their capital shortfall (identified potential redress liabilities less their regulatory capital excess). However, upon their exit we have assumed that their total regulatory capital would be available to cover the total amount of identified potential redress liabilities, £0.6 million, with the remaining identifiable £0.5 million being covered by the FSCS.

69. The number of firms that we estimate will exit the market is low, 13 in our central scenario, compared to the approximately 258 firms that exit the market annually (see paragraph 6 of the CBA), so we do not expect the impact of our proposals on competition to be material.

Illustrative tail event scenarios

70. In addition to our baseline impact assessment above, we considered the impact of our proposed policy on the market under two illustrative scenarios of tail events – first, an event that causes a narrow segment of the market to be affected by a significant increase in complaints and redress liabilities and, second, an event that affects a large proportion of firms that experience an increase in complaints across a range of their products and services.

71. We modelled each event using a Monte Carlo simulation consisting of 1,000 simulation trials. In the following subsections we discuss how we calibrated our simulations for each of the two scenarios. To calculate the firms' potential redress liabilities in each scenario we used the same formula ***Potential redress liabilities = I * A * P***, as in our baseline impact assessment (paragraph 50 of this CBA). We estimated the number of firms that would

be subject to asset retention requirements, the number of firms that would exit and the impact on FSCS costs using the approach discussed in paragraphs 49-63 of this CBA. We present our results in Table 4.

Scenario 1: Narrow impact event

72. In scenario 1, we model an event in which a small proportion of PIFs experience a significant rise in complaints related to advice given on Defined Benefit (DB) pensions. Our choice of DB advice is motivated by it being an area of the market that can generate the largest redress liabilities.

73. For each simulation trial we use the following calibration values:

- We randomly assign 9.9% of PIFs that held permissions for advising on DB pensions in 2022 to be affected by the event. We use this effect rate as it is the ratio of the number of PIFs that had pension related claims in LDII / Investment Provision (IP) / Life and Pensions Provision (LPP) funding classes between 2016-2022 in FSCS data *over* the number of firms that held permissions for advising on DB during the same period (RMAR section M and ad-hoc data requests).
- We assume that for each affected PIF, the number of consumers impacted (***I*** in our baseline impact assessment) is 3.8% of its back-book of DB advice transactions. We compute this value as the average ratio of the volume of pension related claims in LDII / IP/ LPP classes for PIFs in FSCS data *over* the volume of DB advice transactions in the back-book of the PIFs in the FSCS data.
- We assume that for each affected PIF, the probability factor of complaints that are upheld and result in redress (***P*** in our baseline impact assessment) is 54%. This figure is the average uphold rate of pensions-related claims for PIFs in the LDII / IP / LPP classes of FSCS for the period between 2016-2022.
- We assume that for each redress instance, the average redress that the firm is required to pay (***A*** in our baseline impact assessment) is £93,000. This is the average value of compensation of pensions-related claims in the FSCS (pre-abatement amount).
- We assume no PII offset would be available and 100% identification rate.
- We do not include other potential redress liabilities covered in our baseline impact assessment (Table 3) to avoid the possibility of double-counting.

Scenario 2: Wide impact event

74. Our second scenario simulates an event in which the entire volume of past investment and pension advice transactions of a large number of firms is affected, resulting in significant potential redress liabilities.

75. For each simulation trial we use the following calibration values:

- We assume that 50% of the 4,939 PIFs in scope would be affected by the event.
- We assume that for each affected PIF, the number of consumers impacted (***I***) is 34% of the volume of its back-book of pension advice and 5.1% of the volume of its investment advice back-book for the period 2016-2022. 34% is the average ratio of the volume of pension related complaints ***over*** the volume of DB advice transactions in the back-book of the PIFs in scope. 5.1% is the average ratio of the volume of investment related complaints ***over*** the volume of investment advice transactions in the back-book of the PIFs in scope. We compute the volume of investment advice transactions as the total volume of advice transactions (RMAR section K) less the volume of DB advice transactions.
- We assume that for each affected PIF, the probability factor of complaints that are upheld and result in redress (***P***) is 28%. This figure is the average uphold rate of pensions-related claims for PIFs in the LDII / IP / LPP classes of FSCS for the period between 2016-2022.
- We assume that for each redress instance, the average redress that the firm is required to pay (***A***) is £8,933 for investments related complaints and £11,273 for pensions related complaints. These are the average redress amounts per upheld complaints across the firms in scope firms during the period 2016-2022.
- We assume no PII offset would be available. We also assume 50% identification rate for this scenario, because the volume of complaints in scenario 2 are assumed to be much larger than that of scenario 1 so we believe PIFs would be more likely to under-identify their potential redress liabilities.
- We do not include the potential redress liabilities from our baseline impact assessment (Table 3) to avoid the possibility of double-counting.

Results

76. The results of the simulations of our tail event scenario 1 are presented in Table 4.

77. For scenario 1, we estimate that on average 175 PIFs (122+40+13) would be affected by the event, out of which only 13 would not be able to cover their potential redress liabilities and would exit the market. For these PIFs, we estimate that the asset retention requirement would reduce the impact on the FSCS by on average £6.4 million.

Table 4: Results from simulation of Scenario 1 for PIFs in scope

	Number of PIFs with potential redress liabilities without asset retention	Value of *identified* potential redress liabilities of PIFs without asset retention	Number of PIFs with asset retention remaining in the market	Value of *identified* potential redress liabilities of PIFs under asset retention remaining in the market	Number of PIFs that will exit	Value of *identified* potential redress liabilities of PIFs that will exit	Value of *total* potential redress liabilities covered by the PIFs that exit (impact of asset retention)	Impact on FSCS: *Total* potential redress liabilities exceeding total capital resources of PIFs exiting
Average	122	£13.1 million	40	£9.1 million	13	£25.3 million	£6.4 million	£17.4 million
90% confidence interval	[105, 141]	[£8 million, £23.4 million]	[30, 51]	[£5.6 million, £13.4 million]	[8, 19]	[£5.4 million, £70.1 million]	[£1.4 million, £16.3 million]	[£3.3 million, £53.6 million]

Note: Simulation results across 1,000 trials. For this scenario we have assumed that firms would identify 100% of their potential redress liabilities and no PII cover would be available. For the impact of the FSCS costs we apply the £85,000 limit.

78. The results of the simulations of our tail event scenario 2 are presented in Table 5.

79. For Scenario 2, we estimate that, on average, 2,373 PIFs would be affected (1,784+488+101). Out of these, only 101 would not be able to cover their identified potential redress liabilities and would exit the market. The impact on the FSCS from these firms is equal to £138.2 million and is the amount of potential redress liabilities they have identified and cannot cover plus the remaining 50% of their potential redress liabilities which the PIFs did not accurately identify. Because of the asset retention requirements imposed on PIFs that would exit, this means £28.1 million of their potential redress liabilities are covered.

Table 5: Results from simulation of scenario 2 for PIFs in scope

	Number of PIFs with potential redress liabilities without asset retention	Value of identified potential redress liabilities of PIFs without asset retention	Number of PIFs with asset retention remaining in the market	Value of identified potential redress liabilities of PIFs under asset retention remaining in the market	Number of PIFs that will exit	Value of identified potential redress liabilities of PIFs that will exit	Value of total identifiable (unresolved plus 100% of their prospective redress liabilities) potential redress liabilities of PIFs that will exit	Value of total potential redress liabilities covered by the PIFs that exit (impact of asset retention)	Total potential redress liabilities exceeding total capital resources of PIFs exiting
Average	1,784	£116.1 million	488	£50.4 million	101	£83.2 million	£166.3 million	£28.1 million	£138.2 million
90% confidence interval	[1,734, 1,833]	[£100.8 million, £132 million]	[462, 514]	[£42.7 million, £58.3 million]	[90, 112]	[£38.7 million, £126.9 million]	[£77.2 million, £253.8 million]	[£15.1 million, £40.6 million]	[£57.8 million, £216.8 million]

Note: Simulation results across 1,000 trials. For this scenario we assume that the impact on FSCS will be from the total identifiable value of the firms' potential liabilities and not only from the proportion that they identify.

Costs

80. This section outlines costs to firms, consumers, the FCA and the FSCS based on the above impact assessment.

81. These are the estimates that are reasonably practicable to obtain given the available information and data at the time of publication. We may update our estimates, in light of new information we receive during the consultation period, including the pilot data collection (see paragraph 3.55-3.58).

Costs to firms

82. Firms will face costs of compliance where we introduce new rules that deviate from the existing requirements. We set these out below, in line with our proposals in Chapter 3 of the CP.

Familiarisation and gap analysis

83. We expect that the new rules and guidance would be contained in a standard FCA publication. Firms will incur costs in resources needed to familiarise themselves with the rules and address any compliance gaps, and these costs can be estimated using our Standardised Cost Model (SCM). We expect these costs to be incurred only once as a result of the introduction of our proposals, and not on an ongoing basis.

84. We use standard assumptions from our SCM to produce an estimate of familiarisation costs. We anticipate approximately 40 pages of policy documentation excluding the legal instrument. Assuming 300 words per page and a reading speed of 100 words per minute, it would take around 2 hours to read the document. We assume that the number of staff that read the document is 20 in large firms, 5 in medium and 2 in small, and this refers only to compliance staff. The hourly compliance staff salary assumption is based on the Annual Survey of Hours and Earnings published by the Office of National Statistics in 2022, including 30% overheads. We expect all firms in scope to incur familiarisation costs.

85. For the legal instrument, we assume 40 pages of legal text. We anticipate that 4, 2 and 1 legal staff will read the legal instrument in large, medium, and small firms respectively, taking 7 hours each. We are basing the legal staff salary on the Annual Survey of Hours and Earnings published by the Office of National Statistics in 2022.

86. Overall, for the 4,939 firms affected, the total familiarisation and gap analysis cost is estimated to be £2.8 million.

Training costs

87. To comply with our proposals, we expect firms to incur costs in resources to train their staff on new processes and requirements. We estimate these costs using our SCM. We expect these costs to be incurred only once as a result of the introduction of our proposals, and not on an ongoing basis.

88. We estimate that large firms will need to provide 1.5 hours of basic training to their compliance officer (SMF16) plus 3 additional compliance employees (4 in total); medium firms to their compliance officer plus 1 additional employee (2 in total); and small firms only to their compliance manager (1 in total). We base this assumption on the fact that firms are expected to have trained staff for complaints handling, identifying their potential redress liabilities, maintaining adequate financial resources following our existing requirements, and our proposed rules would not have a substantial impact on their governance processes. The hourly compliance staff salary assumption is based on the Annual Survey of Hours and Earnings published by the Office of National Statistics in 2022, including 30% overheads.

89. Overall, for the 4,939 firms affected, the total training cost is estimated to be £1.4 million.

IT related changes

90. We expect firms to incur costs in resources to update their IT systems and processes to comply with the new proposed requirements, namely, to periodically report their calculations in the RMAR and to collect and process any internal data. We expect these costs to be incurred on an ongoing basis.

91. We expect that the one-off cost of IT related changes that the firms need to implement will be negligible, because our proposals build on the existing monitoring that firms are already required to do.

92. We estimate that for the large firms in scope, the project length of IT related changes will be 5 days and for the medium firms 2 days. We base this assumption on the fact that firms are expected to have systems and controls in place to identify their potential redress liabilities following our existing requirements and our proposed rules would not have a substantial impact on their IT systems. We assume that large and medium firms will use in-house teams comprising of software development and design staff, programming staff, project management staff and senior management. The hourly salary of these employees is based on the Annual Survey of Hours and Earnings published by the Office of National Statistics in 2022, including 30% overheads. For the small firms we estimate that they will not need any change in their IT systems and processes, because they do not have a complicated structure neither a sizeable volume of business.

93. Overall, for the 4,939 firms affected, the total ongoing cost of the IT related changes is estimated to be £0.1 million per annum, or a total cost of £0.8 million over the 10-year assessment period (in PV terms as per the Treasury's Green Book).

Governance changes

94. We expect that firms will incur costs in resources to adjust their internal processes or governance arrangements to comply with our proposed requirements, namely, to quantify their potential redress liabilities and to set capital aside. We expect these costs to be incurred on an ongoing basis.

95. We expect that the one-off cost of governance changes that the firms need to implement will not be sizeable, because our proposals build on the existing monitoring that firms are already required to do.

96. We estimate that for the large firms in scope the project length of the governance changes will be 5 days, for the medium firms 2 days, and for the small firms 1 day. We base this assumption on the fact that firms are expected to have governance processes in place for complaints handling, identifying their potential redress liabilities, maintaining adequate financial resources following our existing requirements, and our proposed rules would not have a substantial impact on their governance processes. We also expect that oversight from the board and the executive committee will be necessary. We assume that the teams involved in the project will comprise of one project manager

and the project team. The hourly salary of these employees is based on the Annual Survey of Hours and Earnings published by the Office of National Statistics in 2022, including 30% overheads.

97. Overall, for the 4,939 firms affected, the total governance change cost is estimated to be £5.4 million per annum, with a total net present value for the whole period of £46.5 million, assuming a 3.5% discount rate as per the Treasury's Green Book.

Costs of capital

98. Where firms are asked to put capital aside, this is generally expected to lead to two types of costs to obtain the necessary funds:

- A one-off cost equal to the capital the shareholders of the firm have to put aside
- An ongoing cost equal to the opportunity cost of obtaining this capital (eg the interest rate the firm would pay if it had to borrow the funds)

99. While the capital requirements arising from our proposals should, in theory, result in such costs, the majority of these costs would have to be incurred even absent the proposed rules in our baseline. This is because existing regulatory requirements require firms to monitor their activities and ensure that they have adequate financial resources to, where appropriate, pay redress where they have caused harm to their customers. We are unable to estimate the marginal change of our proposals over and above the existing requirements.

100. Our proposed rules require PIFs to quantify an overall amount for all the potential redress liabilities it has identified and set aside the capital to cover it. It should be noted this is not a permanent increase in minimum capital requirements that could reasonably be translated into a cost. Additionally, firms are already required to maintain appropriate financial resources commensurate to the risk of harm and complexity of their business. Therefore, we do not consider the capital the firm has to put aside as a cost and, in particular, as a cost resulting from our proposals.

101. We acknowledge there may be some opportunity cost due to firms needing to hold the capital earlier than they would absent the intervention. We are unable to reasonably estimate how long a firm would have to hold capital for its potential redress liabilities, but we would generally expect the period of time to be relatively small. This is because we expect firms to be quick to proactively rectify the harm, thereby minimising the additional opportunity costs of holding the capital. Our data on complaints handling suggests that the majority of complaints are resolved in fewer than 8 weeks. As shown in our causal chain, we expect that our proposed rules themselves will contribute to reducing the time firms take to proactively rectify harm.

102. If a firm overestimates the capital they need to set aside to resolve their potential redress liabilities, they would incur disproportionate capital related costs. Conversely, where they underestimate the capital they need to set aside, capital related costs will be correspondingly lower. However, as we discuss above, firms would not hold this capital for a long period so the impact would be negligible.

Costs to consumers

103. Overall, we expect that our proposals will have negligible additional costs to the consumers.

104. Some firms may seek to pass on the costs of complying with our proposed rules to consumers. We capture the size of the additional costs to firms in the previous subsection, so we do not account for those that might be passed on to consumers to avoid double counting. However, given that we estimate a large number of firms to remain in the market, we expect that firms that experience a significant increase in costs will have a limited ability to pass this on to consumers due to competition pressure.

105. As shown in our impact assessment, we estimate that a small number of PIFs (13 firms) will exit the market as an immediate impact of our proposed rules. The customers of any firms that may exit the market are likely to experience costs to identify and switch to an alternative provider. However, given that the number of firms that we estimate will exit is small compared to the 258 firms that exit the market on average every year (paragraph 6 of our CBA), we expect these costs to be negligible.

106. Our proposed rules may discourage firms from providing advice in market segments that they think are more likely to generate redress liabilities. Alternatively, firms may raise prices in these segments to reflect the perceived higher risk of having to pay redress in the future. This may lead to a lack of availability and/or higher costs of advice in specific market segments. We are unable to reasonably quantify this impact but given the large number of firms available in this sector, we expect the cost to consumers from this to be negligible as a result of competition pressure.

Costs to the FCA

107. We expect the FCA will need to make some changes to its systems and data capabilities to implement our proposals, incurring a one-off cost of, at most, £350k, and nil ongoing costs. We will also devote Authorisations and Supervision resources on a one-off and an ongoing basis but we expect these to be covered by redeployment of existing FCA resources ('business-as-usual'). Additional one-off implementation costs of around £100k in total may be incurred by Authorisations. These costs are in line with our public commitment to improve the redress framework and our strategic priority to prevent and reduce serious harm as outlined in the 2023/2024 Business plan.

Costs to the FSCS

108. We expect that there would be an increase in firm exits immediately following the implementation of our proposals, resulting in one-off costs for the FSCS. Firstly, the FSCS will need to cover the unpaid redress liabilities to eligible claimants. Secondly, the FSCS will incur the administrative costs associated with the increase in claims. We expect these costs to be negligible. Both these costs are covered by the FSCS levy which is made up of two elements, management expenses (which covers the costs of running the compensation scheme) and compensation costs.

109. We estimate in our impact assessment (Table 3) that between 6 and 27 firms will exit the market in the immediate aftermath of our policy being implemented, and that only up

to £4.5 million would fall on the FSCS. Because of our proposed asset retention rules we estimate they will be able to cover £6.8 million of their total potential redress liabilities of £11.2 million. This would leave the FSCS to cover the remaining £4.4 million, which is small relative to the £108 million a year they currently incur due to the misconduct of PIFs, and relative to egregious individual cases.

110. The FSCS will bear the cost of processing additional claims associated with firms that exit as a direct result of our proposals being implemented. However, we expect that the increase in claims will be relatively small. In 2021 and 2022, the FSCS received more than 40,000 claims in the LDII class each year (including claims for firms that were not PIFs). In our upper bound estimate, where 27 firms exit the market due to our proposed rules, we estimate that there would be an additional 361 claims made to the FSCS. We therefore do not anticipate a significant increase in administrative costs.

Total net present value of compliance costs

111. We estimate the total net present value of the costs of our proposals, for the period from year 1 until year 10, to be £52 million. We estimate the equivalent annualised compliance cost to be equal to £6 million per annum.

Benefits

Benefits to consumers

112. In paragraph 28, we set out our expectations for how our proposed intervention will benefit consumers. With the information we have and the availability of data, we are unable to reasonably quantify the benefits – something that is not uncommon with prudential rules like those proposed. The main limitation is the non-observability of the true misconduct rate (eg unsuitability rate in advice) in the sector, which is what generates most of the stock of harm that has already been accumulated and may continue to generate harm in the future. Additionally, the Consumer Duty, which requires firms to proactively rectify any foreseeable harm, was only recently introduced, so we do not have enough data yet to assess how PIFs have been complying with the requirements of the Consumer Duty. We have a more detailed discussion of our limitations in the 'Risks and uncertainties' section of our CBA (paragraphs 125 to 131).

113. Under our proposed rules, we expect a greater proportion of redress liabilities generated by PIFs to be covered by firms themselves rather than by the FSCS, which we expect will reduce the moral hazard in the sector. Increasing the proportion of liabilities that are covered by firms themselves may also benefit consumers by reducing the instances of uncompensated harm that occur when the value of redress owed exceeds the £85,000 cap on claims paid out by the FSCS.

114. Under our proposals, the additional capital held by PIFs improves their incentives to proactively offer redress. Requiring firms to hold additional capital prevents them from using those funds for other purposes and therefore limits incentives to delay or to try to avoid paying redress. This will increase the likelihood of customers being offered redress in a timely manner. Speeding up the redress process will save consumers time and alleviate stress that consumers might experience during the complaints process.

115. Our proposed rules, and in particular the requirement for firms to report their liabilities, would improve compliance to existing requirements. Firstly, firms would become more explicitly accountable for the figures they report to us relative to the baseline. As a result, our supervisory and enforcement departments would be better sighted on the potential redress liabilities that firms have. Secondly, firms would have a stronger incentive to assess and improve their conduct in order to lower their potential redress liabilities. These changes would strengthen firms' incentives to improve their conduct, resulting in a decrease in purchases of unsuitable products and an increase in confidence and participation.

116. Decreasing purchases of unsuitable products would lead to secondary benefits in the long run, namely a further reduction in FSCS costs due to less harm being generated by the PIFs.

Benefits to firms

117. Under the proposed rules, asset retention requirements would prevent transactions outside the ordinary course of business and would leave more resources in the system to cover redress than in the baseline. Even for firms that would end up in liquidation/insolvency, more funds would be available for creditors to recover, increasing the likelihood that the FSCS (a creditor in the insolvency process) would be able to recover a part of the redress bill, and the amount of redress it would be able to recover. In our Impact Assessment, we showed that the asset retention requirements could increase the value of redress that is covered by the PIFs before exiting and could increase the funds available for creditors during the insolvency process. This could result in a reduction in FSCS costs.

118. We note that even though the reduction in FSCS costs is a transfer of the redress costs among firms, we consider it a benefit as it constitutes a reduction in the externalities faced by the non-polluters because of the actions of the polluters.

Break even analysis

119. In this section, we assess whether the benefits of our proposed remedy are likely to break even against the remedy's costs (£6 million per annum annualised).

120. As noted earlier, we expect that our proposed remedy will benefit firms and consumers through 4 channels:

- Reduction in FSCS costs due to PIFs exiting
- Decrease in the uncompensated losses that arise from the FSCS's £85,000 compensation limit
- Increase in the number of consumers who will be offered redress in a proactive manner
- Reduction in purchases of unsuitable products

121. We focus our break-even analysis on the first channel (PIF-related FSCS costs) as it is the most tractable. Specifically, we quantify the amount by which costs to the FSCS would have to fall to cover the estimated costs of the remedy.

122. As noted earlier, costs to the FSCS arising from PIFs exiting amounted to £757 million in total for the period 2016-2022, or an average of £108 million per annum. Given our estimate of £6 million per annum annualised costs, our proposed rules will break even if they reduce PIF-related FSCS costs by just 5.6% per year on average.

123. We believe our rules are likely to achieve this, as they are expected to reduce FSCS costs not only by increasing the redress that polluting PIFs themselves pay to customers but also by incentivising them to improve their practices to reduce the need for consumers to claim redress in the first place.

124. Additionally, in the central scenario of our impact assessment we estimate that firms will hold £24.5 million of capital to cover their potential redress liabilities. This £24.5 million would be used to proactively cover potential redress liabilities and would feed directly into two of our benefits: the decrease in the uncompensated harm, and the increase in the number of consumers who will be offered redress in a timely manner. However, we cannot reasonably quantify what proportion of the £24.5 million would amount to a direct benefit.

Risks and uncertainty

125. A key limitation in our analysis is the non-observability of the true misconduct rate (eg unsuitability rate in advice) in the sector, which has generated the stock of harm that has already been accumulated and may create additional harm in the future. The existing complaints and the past FSCS compensation could proxy these variables or offer insights about the trend of the evolution of the stock of harm. However, complaints only reflect a proportion of the problem, due to consumer inertia. Firm activities and misconduct also change over time and past data can only give us an indication and not a true picture of future misconduct. This limitation introduces uncertainty to the estimated potential redress liabilities in the impact assessment, and it has prevented us from quantifying the benefits of our proposals.

126. In our impact assessment, we explained our approach of estimating the quantum of each firm's prospective redress liabilities as a percentage of the redress for complaints that it had paid out in the past six years. This reflects the uncertainty around the size of prospective redress liabilities that each firm will identify. To control for this, we have three scenarios in the impact assessment, and in paragraph 56 we outlined our analysis of the complaints data, which demonstrates that this is a reasonable assumption.

127. The analysis in paragraph 56 of the complaints data implies that there is a risk that in our impact assessment we overestimate the potential redress liabilities that firms would calculate, because some of the firms might not have any potential redress liabilities. However, because of consumer inertia in seeking redress, the complaints that we observe from the historical data might underestimate the potential redress liabilities of

the PIFs. Overall, there is a degree of uncertainty around the exact value of the potential redress liabilities.

128. Another limitation is that the degree of compliance with existing requirements is not accurately observable. We note that the Consumer Duty, which requires firms to proactively rectify any foreseeable harm, was only recently introduced. However, the high FSCS liabilities that firms leave on the FSCS after exiting the market and our supervisory experience suggest that firms are not complying with existing requirements on maintaining adequate financial resources in the way that we would expect them to.

129. We are also uncertain about the degree of PII cover of potential redress liabilities. We would generally expect PII to cover eligible liabilities and note that PII contracts generally contain clauses which allow a firm to maintain cover so long as they have notified a PII provider about information or circumstances that could lead to a claim under the policy. We are aware that PII policies have exemptions and restrictions as well which can limit this cover, although PII policies are not permitted to contain conditions or exclusions which unreasonably limit cover. To control for this uncertainty, we have modelled in our impact assessment two levels of PII cover. We also seek feedback from PII providers as part of this consultation.

130. There is a risk that if compliance with our proposals is very low, especially from firms with high potential redress liabilities that would seek to avoid them, our proposals would not be able to deliver the benefits that we expect and we outline in the causal chain. However, we expect that the reporting requirements that are part of our proposals will strengthen our supervisory abilities and enforcement efficiency, all of which would mitigate this risk.

131. We may update our assumptions and our subsequent estimations, in light of new information and feedback we receive during the consultation period, including the pilot data collection (see paragraph 3.58).

Secondary competitiveness and growth objective

132. The compensation liabilities that fall upon the FSCS due to the redress liabilities of PIFs are reflected in the higher levies paid by industry. Higher costs can negatively impact competition and potentially limit innovation in the market. Under our proposals, a greater proportion of redress liabilities would be covered by the polluters themselves. This would reduce costs to the FSCS who will pass on these savings to industry in the form of a reduction in the levy. Lower costs for firms will promote effective competition in the market, thereby driving the innovation and efficiency necessary to support economic growth.

133. Under our proposals, firms that comply with their regulatory requirements and do not have foreseeable harm should not need to set aside any additional capital. But we want firms that may be generating redress liabilities to have more 'skin in the game', to incentivise better practice in the longer term. By targeting those firms that generate liabilities, we ensure our rules are proportionate. This contributes to making the UK financial services industry a more attractive place to participate in, both within the UK

and globally for financial services workers, thereby improving competition and the UK's competitiveness as a financial hub.

134. Our rules would speed up the redress process for consumers, reduce the likelihood of uncompensated losses that result from their claim being above the £85,000 cap on claims paid by the FSCS, and improve the conduct of firms. We expect these changes to help increase consumers' trust in the market. Should trust in the market increase, it will encourage take-up of appropriate financial services products, which helps underpin economic growth.

135. In the causal chain of this CBA we show how our proposals help achieve our secondary competitiveness and growth objective.

Q34: **Do you have any views on the cost benefit analysis, including our analysis of costs and benefits to consumers, firms and the market?**

Q35: **Do you have any views on whether there are costs specific to small firms that need to be captured further in the cost benefit analysis?**

Annex 3

Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules (a) is compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, (b) so far as reasonably possible, advances the secondary international competitiveness and growth objective, under section 1B(4A) FSMA, and (c) complies with its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of His Majesty's Government to which we should have regard in connection with our general duties.

5. This Annex includes our assessment of the equality and diversity implications of these proposals.

6. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

The FCA's objectives and regulatory principles: Compatibility statement

7. The proposals in this consultation are compatible with the FCA's strategic objective to ensure that relevant markets function well. They would improve the incentives for firms to deliver better consumer outcomes in the first place, and improve firm resilience when things go wrong.

8. This work links to our 3-year Strategy, designed to improve outcomes for consumers and markets by reducing harm, and promoting competition and positive change. We consider these proposals set out in this consultation will help us advance each of our operational objectives, as set out in paragraphs 2.22-2.26 of this Consultation Paper.

9. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles required of us by s. 3B FSMA, as further detailed below.

The need to use our resources in the most efficient and economical way

10. We consider the proposed measures in this consultation are a proportionate use of our resources. As we explain in this consultation paper, the measures will streamline our supervisory processes regarding problem firms and the data provided under the proposals will allow us to target our resources in the most efficient and economical way. This may in turn inform our future policy and assist us with reviewing the rules if introduced and provide us with data we otherwise would not have and would need to collect. We considered an alternative of targeted supervision; however we believe cost savings to firms would be minimal and less effective, further details are set out in paragraphs 32-34 in Annex 2.

The principle that a burden or restriction should be proportionate to the benefits

11. We consider our proposals to be proportionate to the benefits. Our assessment of the costs and benefits of these proposals is set out in Annex 2.

The need to contribute towards achieving compliance by the Secretary of State with section 1 of the Climate Change Act 2008 (UK net zero emissions target)

12. We do not consider the proposals in this consultation to be relevant to the making of such a contribution and are satisfied that these proposals would have no adverse impact.

The general principle that consumers should take responsibility for their decisions

13. Clearer public information on PIFs subject to asset retention requirements will allow consumers to make better informed decisions on who they do business with.

The responsibilities of senior management

14. Senior managers will be responsible for putting in place and overseeing measures to quantify and report on potential redress liabilities as well as complying with asset retention requirements.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

15. Our intervention is specifically designed to be proportionate, build on existing obligations and target the firms that generate redress liabilities. We are seeking to take a proportionate response to minimise the burden on firms and target the firms most likely to generate liabilities. While we are introducing a new requirement for all firms to quantify potential redress liabilities and report them to the FCA, only firms that have identified potential redress liabilities will have to set aside capital and only those that cannot do this will be subject to asset retention requirements.

16. As we set out in paragraph 3.66, the asset retention requirements will only apply to those kinds of business organisation for which they are appropriate and the rules will only apply when risks are not assessed at group level (paragraph 3.5-3.10).

The desirability of publishing information relating to persons subject to requirements imposed under FSMA or requiring them to publish information

17. As we set out in paragraph 3.65, we are proposing to publish information about which firms are subject to asset retention requirements on our Financial Services Register. We expect that the benefits of this in terms of transparency, both to the market and consumers, outweigh the costs in terms of reputational risks to the firm.

The principle that we should exercise our functions as transparently as possible

18. This Consultation Paper sets out our policy justification for these proposals, CBA and compatibility with our legal duties. The consultation is open for 16 weeks and we welcome responses from all stakeholders. We will consider all responses before deciding whether to proceed to make rules in the form proposed in this consultation. This is subject to the approval of the FCA Board.

19. We have been transparent in our commitment to review the prudential regime for PIFs. This was set out in our Consumer Investments Strategy 2021, and we reaffirmed our commitment in the 1-year update.

20. We will be engaging with relevant statutory panels during the consultation period. We will also deliver a comprehensive engagement plan including facilitating round tables to enable stakeholders to feed into the proposals.

Financial Crime

21. In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s 1B(5)(b) FSMA).

Expected effect on mutual societies

22. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.

Compatibility with the duty to promote effective competition in the interests of consumers

23. In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers. We believe that the proposals promote effective competition in the interests of consumers for the reasons set out in paragraphs 2.25 and 2.26.

Equality and diversity

24. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, and foster good relations between people who share a protected characteristic and those who do not.

25. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in paragraph 2.35 of the Consultation Paper.

Legislative and Regulatory Reform Act 2006 (LRRA)

26. We have had regard to the principles in the LRRA for the parts of the proposals that consist of general policies, principles or guidance. We consider that our proposals are transparent, accountable, proportionate, and consistent. For example, our intervention

is specifically designed to be proportionate, build on existing obligations and target the firms that generate redress liabilities.

27. We have had regard to the Regulators' Code for the parts of the proposals that consist of general policies, principles or guidance. We consider that our proposals are consistent with the principles of the code. For example, we have included guidance in our rules and examples in our Consultation Paper to help firms meet their responsibilities to comply.

Treasury recommendations about economic policy

28. This section explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of His Majesty's Government to which we should have regard in connection with our general duties.

29. We consider that our proposals are consistent with the aspects of the Government's economic policy to which the Financial Conduct Authority should have regard. In the remit letter from the Chancellor of the Exchequer to the FCA on 9 December 2022, the Chancellor affirms the FCA's role in protecting consumers, promoting competition in financial services and protecting and enhancing the integrity of the UK financial system. The FCA has regard to this letter and the recommendations within.

Supporting the Government's objective of medium to long-term economic growth in the interests of consumers and businesses

30. The proposals contained in this paper support the Government's objective of medium to long term economic growth in the interests of consumers and businesses. See 2.27 to 2.29 for further detail.

Supporting the government's objective to promote the international competitiveness of the UK

31. The proposals contained in this paper support the Government's objective to promote international competitiveness of the UK. Please see 2.27 to 2.29 for further detail.

Annex 4

Abbreviations used in this paper

Abbreviation	Description
AGBR	Advice Guidance Boundary Review
AR	Appointed Representative
CAD	Capital Adequacy Directive
CBA	Cost Benefit Analysis
COBS	Conduct of Business Sourcebook
CRR	Capital Requirements Regulation
CP	Consultation Paper
DB	Defined Benefits
FCA	Financial Conduct Authority
FRS	Financial Reporting Standards
FLS	Financial Lives Survey
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
ICARA	Internal Capital and Risk Assessment
IP	Investment Provision
IPRU – INV	Prudential sourcebook for Investment Businesses
LDII	Life Distribution and Investment Intermediation
LLP	Limited Liability Partnership
LPP	Life & Pensions Provision
LRRA	Legislative and Regulatory Reform Act 2006

Abbreviation	Description
MAR	Market Abuse Regime
MiFID	Markets in Financial Instruments Directive
MIFIDPRU	Prudential sourcebook for MiFID Investment Firms
MIPRU	Mortgage and Home Finance Firms, and Insurance Intermediaries
PIF	Personal Investment Firm
PII	Professional Indemnity Insurance
PSED	Public Service Equality Duty
RMAR	Retail Mediation Activities Return
SII	Solvency II
SIPP	Self-Invested Personal Pension

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Appendix 1

Draft Handbook text

PERSONAL INVESTMENT FIRMS (CAPITAL DEDUCTION FOR POTENTIAL CONSUMER REDRESS) INSTRUMENT 2024

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (The FCA's general rules);
(2) section 137T (General supplementary powers); and
(3) section 139A (Power of the FCA to give guidance).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. The modules of the FCA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)	Annex B
Interim Prudential sourcebook for Investment Businesses (IPRU-INV)	Annex C
Supervision manual (SUP)	Annex D

Notes

E. In this instrument, the notes (indicated by "**Note:**" or "*Editor's note*:") are included for the convenience of readers but do not form part of the legislative text.

Citation

F. This instrument may be cited as the Personal Investment Firms (Capital Deduction for Potential Consumer Redress) Instrument 2024.

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Insert the following new definitions in the appropriate alphabetical position. The text is not underlined.

asset retention requirement — (in *IPRU-INV* 13) means the asset retention requirement in *IPRU-INV* 13.17.6R.

capital deduction for redress — (in *IPRU-INV* 13, *MIPRU* and *SUP*) has the meaning in *IPRU-INV* 13.16.22R.

potential redress liability — (in *IPRU-INV* 13) means an *unresolved redress liability* or a *prospective redress liability*.

probability factor — (in *IPRU-INV* 13) means the probability factor that a *firm* may apply to discount its *potential redress liabilities* in accordance with *IPRU-INV* 13.16.26R and *IPRU-INV* 13.16.27R.

prospective redress liability — (in *IPRU-INV* 13) means a potential obligation to provide redress or remediation that:

(1) exists under *IPRU-INV* 13.16.16R;

(2) has not ceased to exist under *IPRU-INV* 13.16.18R; and

(3) is not an *unresolved redress liability*.

unresolved redress liability — (in *IPRU-INV* 13) means a potential obligation to provide redress or remediation that exists under *IPRU-INV* 13.16.11R and has not ceased to exist under *IPRU-INV* 13.16.13R

Amend the following definitions as shown.

complaint …

(3) (in *PRIN*, *DISP* 1.1, *IPRU-INV* 13 and (in relation to *collective portfolio management*) in the *consumer awareness rules*, the *complaints handling rules* and the *complaints record rule*) any oral or written expression of dissatisfaction, whether justified or not, from, or on behalf of, a *person* about the provision of, or failure to provide, a financial service, *claims management service* or a *redress*

determination, which alleges that the complainant has suffered (or may suffer) financial loss, material distress or material inconvenience.

…

connected person …

(6) …

(7) (in *IPRU-INV* 13):

(a) a member of the same *group* as the *firm*;

(b) a *controller*, shareholder or member of the *firm*;

(c) a *director*, other *officer* or *employee* of the *firm*, or of any member of the same *group* as the *firm*;

(d) a *close relative* of a *person* falling within sub-paragraph (b) or (c);

(e) an agent acting on behalf of a *person* falling within sub-paragraphs (a) to (d); or

(f) any other *person* ('A') in relation to whom the following conditions are met:

(i) the *firm* (or another *person* falling within sub-paragraphs (a) to (e)) has provided, has agreed to provide or is proposing to provide, a financial benefit to A; and

(ii) A either:

(1) is a *person* who has been directly involved in, or has been responsible for the activity giving rise to the *potential redress liability*; or

(2) is controlled by a *person* who falls within (1).

RMAR (in *SUP* and *IPRU-INV* 13) a Retail Mediation Activities Return, containing data specified in *SUP* 16 Annex 18A and relevant to the *firm's* type and *regulated activities*.

Annex B

Amendments to the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text.

4 Capital resources

4.1 Application and purpose

…

Application: firms carrying on designated investment business only

…

4.1.7 G A *firm* which carries on *designated investment business*, and no other *regulated activity*, may disregard this chapter. For example, a *firm* with *permission* limited to *dealing in investments as agent* in relation to *securities* is only carrying on *designated investment business* and may be subject to the Prudential sourcebook for MiFID Investment Firms (*MIFIDPRU*) or the Interim Prudential sourcebook for Investment Businesses (*IPRU(INV)*), as appropriate. However, if its *permission* is varied to enable it to arrange motor insurance as well, this activity is not *designated investment business* so the *firm* will be subject to ~~the higher of the~~ requirements in this chapter and those sourcebooks ~~(see~~ as set out in *MIPRU* 4.2.5R and *MIPRU* 4.2.5AG~~)~~.

…

4.2 Capital resources requirements

…

Capital resources requirement: firms carrying on regulated activities including designated investment business

…

4.2.5A G The capital resources requirement for a *firm* (other than a *credit union*) carrying on *regulated activities*, including *designated investment business*, which is also subject to Chapter 13 of the Interim Prudential sourcebook for investment businesses is the amount calculated in *IPRU(INV)* 13.13.3R.

…

4.4 Calculation of capital resources

The calculation of a firm's capital resources

4.4.1 R (1) …

(2) If the *firm* is subject to the Prudential sourcebook for MiFID Investment Firms (*MIFIDPRU*) or Chapter 3 or 5 of the Interim Prudential sourcebook for investment businesses (*IPRU(INV)*), the capital resources are the higher of:

…

(b) …

(3) If the *firm* is subject to Chapter 13 of the Interim Prudential sourcebook for investment businesses (*IPRU-INV*), the capital resources are the higher of:

(a) the amount calculated under (1) less the *capital deduction for redress*; and

(b) the capital resources calculated under *IPRU-INV* 13.15.

…

Annex C

Amendments to the Interim Prudential sourcebook for Investment Businesses (IPRU-INV)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

1 Application and General Provisions

1.1 PURPOSE

…

1.1.5 R <u>(1)</u> On becoming authorised by the *appropriate regulator* a *firm* will have to comply with the particular chapter of this sourcebook appropriate to its business. The *firm* will be able to seek guidance on this during the authorisation procedure. If subsequently, the business for which a *firm* has *permission* changes it may be necessary for it to comply with a different set of financial resources requirements. *Firms* will be able to discuss this aspect with the appropriate regulator during the application process.

<u>(2)</u> <u>The different chapters of this sourcebook have been developed with different business models and different risks in mind. For example, *IPRU-INV* 13 (Financial Resources Requirements for Personal Investment Firms) has been developed for *firms* that carry on activities such as *advising on investments* with customers that include *retail clients*. The *FCA* will therefore generally expect such a *firm* to comply with *IPRU-INV* 13, except where it is a *MIFIDPRU investment firm* and therefore subject to *MIFIDPRU*.</u>

…

13 Financial Resources Requirements for Personal Investment Firms

13.1 APPLICATION, GENERAL REQUIREMENTS AND PROFESSIONAL INDEMNITY INSURANCE REQUIREMENTS

…

Capital resources: general accounting principles

13.1.4A R (1) Unless a *rule* provides otherwise, a *firm* must:

(a) recognise an asset or liability; and

(b) measure the amount of that asset or liability,

by using the accounting principles it applies in preparing the *firm's* reporting form in (2).

(2) The accounting principles are referred to in the Notes for completion of the Retail Mediation Activities Return (*RMAR*) (under the heading "Accounting Principles") in *SUP* 16 Annex 18BG.

13.1.4B G *Firms* will note that *IPRU-INV* 13.16 supplements the accounting principles by requiring *firms* to quantify and set aside capital resources for potential redress or remediation, even if the accounting principles do not require recognition of the liability.

…

13.15 CALCULATION OF OWN FUNDS TO MEET THE CAPITAL RESOURCES REQUIREMENT FOR A PERSONAL INVESTMENT FIRM

Application

…

13.15.3 R A *firm* must calculate its capital resources in accordance with table 13.15.3(1).

Table 13.15.3(1)

This table forms part of *IPRU-INV* 13.15.3R.

Capital resources	
Companies	**Sole traders: Partnerships**
…	…
less - *Capital deduction for redress* (Note 2) - Intangible assets - …	less - *Capital deduction for redress* (Note 2) - Intangible assets - …
Note 1 … **Note 2** *Firms* that are part of prudentially supervised groups may be exempt from the *capital deduction for redress* under *IPRU-INV* 13.16.2R.	

…

Insert the following new chapters, IPRU-INV 13.16, IPRU-INV 13.17 and IPRU-INV 13.18, after IPRU-INV 13.15 (CALCULATION OF OWN FUNDS TO MEET THE CAPITAL RESOURCES REQUIREMENT FOR A PERSONAL INVESTMENT FIRM). The text is not underlined.

13.16 Capital deduction for redress

Purpose

13.16.1 G (1) *Firms* may need to provide redress or remediation following a *complaint* from an *eligible complainant* (*DISP* 1.4.1R).

(2) *Firms* are also required to monitor consumer outcomes (see *PRIN* 2A.9), and to have appropriate management controls in their complaints handling to identify any recurring or systemic problems (*DISP* 1.3.3R). Where *firms* identify issues under *PRIN* 2A.2.5R, they are required by *PRIN* 2A.10.2R to consider what remedial action is appropriate, which may include proactively offering redress.

(3) *Firms* are required to maintain adequate financial resources under *Principle* 4 and the *threshold conditions*. As explained in FG 20/1 Our framework: assessing adequate financial resources (https://www.fca.org.uk/publication/finalised-guidance/fg20-1.pdf), the *FCA* specifically expects *firms* to have and maintain adequate financial resources to be able to provide redress.

(4) *IPRU-INV* 13.16 builds on (1) to (3) by requiring a *firm* to quantify and set aside capital resources to pay for potential redress or remediation. *IPRU-INV* 13.16 supplements the accounting principles for the recognition of liabilities, and may require a *firm* to quantify and set aside capital resources to pay for potential redress or remediation even if the relevant accounting principles do not require recognition of the liability.

Scope

13.16.2 R *IPRU-INV* 13.16 does not apply to any of the following:

(1) a *firm* that:

(a) is part of an *investment firm group* under *MIFIDPRU* 2 that operates an *ICARA process* on a *consolidated basis*, as described in *MIFIDPRU* 7.9.4G; and

(b) has notified the *FCA* that it is relying on the exemption in *IPRU-INV* 13.16.2R(1) by:

(i) submitting the notification form in *SUP* 15 Annex 4;

(ii) specifying that the notification relates to *IPRU-INV* 13.16.2R(1);

(iii) sending the notification through online submission on the *FCA's* website [*Editor's note: firms* will be able to use the website for this purpose in or after December 2023] or by electronic mail to the *firm's* usual supervisory contact; and

(iv) explaining why the *firm* qualifies for the exemption; or

(2) a *firm* that:

(a) is part of a group supervised under Chapter 2 of Title II of Part One of the *UK CRR* or the Solvency II Firms: Group Supervision part of the *PRA Rulebook*;

(b) operates a group risk assessment process which achieves equivalent outcomes to an *ICARA process* operated on a *consolidated basis*; and

(c) has notified the *FCA* that it is relying on the exemption in *IPRU-INV* 13.16.2R(2) by:

(i) submitting the notification form in *SUP* 15 Annex 4;

(ii) specifying that the notification relates to *IPRU-INV* 13.16.2R(2);

(iii) sending the notification through online submission on the *FCA's* website [*Editor's note: firms* will be able to use the website for this purpose in or after December 2023] or by electronic mail to the *firm's* usual supervisory contact; and

(iv) explaining why the *firm* qualifies for the exemption.

13.16.3 R *IPRU-INV* 13.16 applies with respect to *potential redress liabilities* in connection with *designated investment business* and connected *ancillary activities*.

Potential redress liabilities incurred in respect of appointed representatives and other persons

13.16.4 R For the purposes of this chapter, a *firm's potential redress liabilities* include:

(1) any *potential redress liabilities* incurred by an *appointed representative*, for which the *firm* has responsibility as principal; and

(2) any other *potential redress liabilities* incurred by a *person* other than the *firm*, for which the *firm* is liable (for example, under a deed poll).

Interaction with liabilities recognised by accounting principles

13.16.5 R A *firm* may disregard a *potential redress liability* for the purposes of *IPRU-INV* 13.16 if:

(1) the *firm* has already recognised the *potential redress liability* in its financial statements in accordance with the relevant accounting principles; and

(2) recognition of the liability has reduced the *firm's* capital resources calculated under *IPRU-INV* 13.15.

13.16.6 G *IPRU-INV* 13.16 supplements the accounting principles for the recognition of liabilities, but does not replace those principles. If a *firm* has already recognised a provision for redress or remediation as a liability in its financial statements, addressing the same liability under this chapter would result in double-counting. As a result, liabilities that have already been recognised in a *firm's* financial statements in a way that reduces the *firm's* capital resources can be disregarded for the purposes of this chapter.

The basic obligation

13.16.7 G The basic obligation in *IPRU-INV* 13.16.8R supplements requirements elsewhere in the *Handbook* to:

(1) have effective and transparent procedures for the reasonable and prompt handling of *complaints* (*DISP* 1.3.1R);

(2) maintain complaints handling controls that identify and remedy recurring or systemic problems (*DISP* 1.3.3R); and

(3) monitor consumer outcomes to, among other things, identify whether *retail customers* have suffered harm as a result of a *firm's* acts or omissions (*PRIN* 2A.9.10R(3)), and if so, where such harm was foreseeable, act in good faith and take appropriate action to rectify the situation (*PRIN* 2A.2.5R).

13.16.8 R If a *firm* identifies a *potential redress liability*, it must quantify and set aside capital resources for the potential redress or remediation.

13.16.9 G The remainder of *IPRU-INV* 13.16 contains *rules* and *guidance* which supplement the basic obligation in *IPRU-INV* 13.16.8R. Specifically:

(1) *IPRU-INV* 13.16.10G to *IPRU-INV* 13.16.20G explain the meaning of the terms *potential redress liability*, *unresolved redress liability* and *prospective redress liability*;

(2) *IPRU-INV* 13.16.21R to *IPRU-INV* 13.16.29G explain how a *firm* must quantify *potential redress liabilities*;

(3) *IPRU-INV* 13.16.30G explains how a *firm* must set aside capital resources for *potential redress liabilities*; and

(4) *IPRU-INV* 13.16.31G explains how frequently a *firm* should repeat the process in (1) to (3) above.

Potential redress liabilities

13.16.10 G A *potential redress liability* is either an *unresolved redress liability* or a *prospective redress liability*. The following sections explain when *unresolved redress liabilities* and *prospective redress liabilities* exist and cease to exist.

Unresolved redress liabilities

13.16.11 R An *unresolved redress liability* exists where:

(1) a *firm* receives a *complaint* from, or on behalf of, an *eligible complainant*; and

(2) the *complaint* could give rise to an obligation to provide redress or remediation to an *eligible complainant*.

13.16.12 G An *unresolved redress liability* includes a *complaint* that is, or may be, considered by the *firm* or the *Financial Ombudsman Services* under the *FCA's DISP* sourcebook. It also includes a matter initiated by, or on behalf of, an *eligible complainant* that is subject to another dispute resolution mechanism (e.g. court proceedings), or a matter subject to preparatory correspondence ahead of any dispute resolution process.

13.16.13 R An *unresolved redress liability* ceases to exist once the *complaint* has been resolved in accordance with the requirements of the *regulatory system*, and there is no realistic prospect of it being reopened.

13.16.14 G A non-exhaustive list of examples of where a *firm* may conclude that an *unresolved redress liability* has ceased to exist is set out below:

(1) the *firm* has made an offer of redress or remediation in accordance with the requirements of the *regulatory system*, its offer has been accepted and the redress or remediation provided;

(2) the *firm* has issued its final response to a *complaint* without making an offer of redress or remediation, and the relevant time limits in *DISP* 2.8 have expired without any referral of the *complaint* to the *Financial Ombudsman Service*; or

(3) the *Financial Ombudsman Service* has determined a *complaint* against the *firm* without making an award of redress or remediation.

Prospective redress liabilities

13.16.15 G (1) *PRIN* 2A.9.10R(3) requires *firms* to monitor outcomes to identify whether any *retail customers* have suffered harm as a result of the *firm's* acts or omissions.

(2) *DISP* 1.3.3R(1) requires *firms* to identify recurring or systemic problems by identifying root causes common to types of *complaint*.

13.16.16 R A *prospective redress liability* exists where:

(1) a *firm* has identified foreseeable harm that could give rise to an obligation to provide redress or remediation to a *retail customer* under *PRIN* 2A.2.5R; or

(2) a *firm* has identified recurring or systemic problems in the course of its complaints handling under *DISP* 1.3.3R that could give rise to an obligation to provide redress or remediation to a *customer*.

13.16.17 G (1) A *firm* should quantify and set aside capital resources for a *prospective redress liability* as soon as it has identified the foreseeable harm, or recurring or systemic problem. This means a *firm* should set aside capital resources on a precautionary basis, even when it is investigating the specific circumstances of the *prospective redress liability*.

(2) A *prospective redress liability* may not actually give rise to an obligation to provide redress or remediation. *IPRU-INV* 13.16 accounts for the fact that not all *potential redress liabilities* will necessarily result in an obligation to provide redress or remediation, by allowing a *firm* to apply a *probability factor* that may reduce the value of its *potential redress liabilities*.

(3) The *FCA* does not consider that identifying a *prospective redress liability* amounts to an admission of culpability or wrongdoing on the *firm's* part. Rather, the *FCA* considers that proper identification of *prospective redress liabilities* is a sensible risk management practice in line with *Principle* 3 and *SYSC* 4, and supports a *firm* in carrying on its business in a sound and prudent manner.

13.16.18 R A *prospective redress liability* ceases to exist once it has been resolved in accordance with the requirements of the *regulatory system* and there is no realistic prospect of it being reopened.

13.16.19 G A non-exhaustive list of examples of where a *firm* may conclude that a *prospective redress liability* has ceased to exist is set out below:

(1) The *firm* has (in accordance with the requirements of the *regulatory system*):

(a) investigated the issue;

(b) made offers of redress or remediation to the relevant customers;

(c) had its offers accepted; and

(d) provided the redress or remediation.

(2) The *firm* has (in accordance with the requirements of the *regulatory system*):

(a) investigated the issue;

(b) concluded that it is not appropriate to provide redress or remediation; and

(c) explained its decision to the relevant customers.

13.16.20 G The following example illustrates how a *firm* should identify *prospective redress liabilities*.

(1) A *firm* ('Firm Z') identifies recurring problems relating to *investment advice* given by one of its *advisers* ('Employee X') about certain higher risk, fixed-term investment products. A number of customers have already complained that these investment products did not suit their cautious attitude to risk or overall portfolio, which they say has caused them a loss. Firm Z treats these as *unresolved redress liabilities* and complies with its obligations accordingly. However, Firm Z considers that the root causes of these issues may also affect other customers and may therefore give rise to *prospective redress liabilities*.

(2) Following initial investigations into the advice provided by Employee X, Firm Z identifies 20 customers who have not complained, but who received potentially unsuitable advice about these products. For the time being, Firm Z quantifies and sets aside capital resources for 20 *prospective redress liabilities* using the information available to it, while it investigates the circumstances.

(3) Firm Z reviews the advice provided to the 20 customers. Firm Z concludes that the advice provided to 12 customers was unsuitable because the product was not aligned with the cautious attitude to risk indicated by these customers. Firm Z concludes that the advice provided to the 8 remaining customers was suitable and aligned to their attitude to risk. Firm Z writes to the 8 customers to explain its assessment and that the customer has a right to complain if they are not satisfied with that decision. At this point, Firm Z ceases to

identify *prospective redress liabilities* in respect of the 8 customers.

(4) Firm Z continues to quantify and set aside capital resources for the remaining 12 *prospective redress liabilities* while it obtains further information and assesses what redress or remedial action is appropriate in accordance with the requirements of the *regulatory system*.

(5) Firm Z completes its assessment of the 12 *prospective redress liabilities*. It communicates the outcome of its assessment to each of the 12 customers and provides the relevant redress or remediation in accordance with the requirements of the *regulatory system*. From this point, Firm Z no longer needs to quantify and set aside capital resources for these *prospective redress liabilities*.

(6) Firm Z subsequently receives *complaints* from 2 of the 8 customers for which it concluded that the advice was suitable and aligned to their attitude to risk. The customers dispute Firm Z's assessment. Firm Z therefore identifies 2 *unresolved redress liabilities* in accordance with *IPRU-INV* 13.16.11R until such time as the *complaints* are resolved in accordance with the requirements of the *regulatory system* and there is no realistic prospect of them being reopened.

Quantifying potential redress liabilities

13.16.21 R A *firm* must quantify an amount for all of its *potential redress liabilities* by:

(1) making a reasonable estimate of the amount of funds it would need to provide redress or remediation to each customer if the liability crystallised, after accounting for any professional indemnity insurance in accordance with *IPRU-INV* 13.16.24R;

(2) adding together the amounts in (1); and

(3) multiplying (2) by the *probability factor*.

13.16.22 R The total amount that a *firm* quantifies under *IPRU-INV* 13.16.21R is referred to as the *firm's capital deduction for redress*.

Estimating an amount for each potential redress liability

13.16.23 G (1) The *FCA* expects a *firm* to make a reasonable estimate of the amount of funds it would need to provide redress or remediation to each customer, using the best information available to it.

(2) A *firm* should consider the following:

(a) any financial loss (including consequential or prospective loss), pain or suffering, damage to reputation, distress or inconvenience that may have been caused to the customer;

(b) the cost of putting right the matters in (a), whether by paying redress or taking other remedial action; and

(c) any relevant *guidance* published by the *FCA* or the *Financial Ombudsman Service* on redress or remediation.

(3) A *firm* should also consider any similar *complaints* that it has resolved in the past, and how the circumstances of its past *complaints* compare to the circumstances of any *potential redress liabilities*.

(4) In some circumstances, it may be appropriate for *firms* to consider groups of *potential redress liabilities* together (for example, where they relate to similar issues).

(5) *IPRU-INV* 13.16.24R allows a *firm* to account for its professional indemnity insurance when estimating the amount of redress. In many cases, this will allow a *firm* to use the excess under its professional indemnity insurance policy as the estimated amount of funds it would need to provide redress.

(6) *Firms* are required to retain records of their approach in accordance with *SYSC* 9, and the *FCA* will expect *firms* to be able to explain their approach, if asked.

Accounting for professional indemnity insurance

13.16.24 R (1) A *firm* may reduce the amount of funds to provide redress to reflect the cover provided by its professional indemnity insurance policy (the 'policy'), subject to the conditions set out in this rule.

(2) Any reduction must not exceed the amount that the *firm* could reasonably expect to recover under the policy, taking into account any policy limitations, exclusions, conditions or excesses.

(3) In complying with (2):

(a) Where a policy excludes a *potential redress liability* from coverage, a *firm* must not reduce the amount for that liability.

(b) Where a policy contains an excess, the reduction in the amount must not incorporate the value of any excess which the *firm* itself still has to fund.

(c) Where a policy contains an aggregate limit or sub-limit of indemnity, the reduction that a *firm* applies for all relevant *potential redress liabilities* must not exceed the value of the

aggregate limit or sub-limit of indemnity. A *firm* must therefore calculate an appropriate reduction per *potential redress liability* so that the aggregate reduction across all *potential redress liabilities* does not exceed the value of the aggregate limit or sub-limit of indemnity.

13.16.25 G The following example illustrates how a *firm* may apply the reduction for professional indemnity insurance in *IPRU-INV* 13.16.24R.

(1) A *firm* ('Firm Y') has upheld 4 *complaints* relating to a particular adviser giving unsuitable pension transfer advice.

(2) Firm Y analyses the causes of these *complaints* in accordance with *DISP* 1.3.3R, and identifies that they share a common root cause, which indicates recurring or systemic problems.

(3) Firm Y identifies 3 additional customers who have not complained, but who received pension transfer advice from the same adviser which has similar characteristics to the *complaints* that were upheld. The *firm* therefore identifies 3 *prospective redress liabilities*.

(4) Based on recent, similar *complaints* that Firm Y has paid redress for, it estimates a reasonable amount of redress for each claim as £180,000 for claim 1, £200,000 for claim 2 and £220,000 for claim 3. The *firm* would therefore be required to quantify an amount of £600,000 for these *prospective redress liabilities*.

(5) However, Firm Y has a valid professional indemnity insurance policy and therefore considers its terms.

(6) Firm Y needs to consider the maximum amount that the *firm* could reasonably expect to recover under the policy, taking into account any policy exclusions or conditions.

(7) Firm Y considers the exclusions in its policy. There are no exclusions which are relevant to these *prospective redress liabilities*.

(8) Firm Y considers its policy excess. The excess for pension transfer advice claims is £10,000 per claim. Firm Y therefore concludes that the reduction in the amount of capital must not include the excesses of £10,000 per claim (i.e. it would not be able to reduce the amounts to less than £30,000 in aggregate for the 3 potential claims).

(9) Firm Y then considers the implications of any policy limits or sub-limits of indemnity. The policy includes a sub-limit of indemnity at an aggregate level of £240,000 for pension transfer advice claims after any excesses or deductibles have been applied. Firm Y therefore concludes that it would only be able to recover £240,000

of the £600,000 of the total prospective redress liabilities that it has identified. This means it has £360,000 of total *prospective redress liabilities*.

(10) As *IPRU-INV* 13.16.21R(1) requires Firm Y to estimate the amount of funds it would need to provide redress to each customer for each *prospective redress liability*, after accounting for its professional indemnity insurance, Firm Y needs to calculate how the maximum level of cover under the policy translates to each *prospective redress liability*. It therefore divides its aggregate *prospective redress liabilities* (£360,000) by the number of *prospective redress liabilities* (3).

(11) For each *prospective redress liability*, Firm Y therefore assesses the amount of redress for each customer at £120,000.

Applying the probability factor

13.16.26 R A *firm* may apply a *probability factor* of 28% to its *potential redress liabilities*, subject to *IPRU-INV* 13.16.27R.

13.16.27 R (1) This *rule* applies where a *firm* has reasonable grounds to believe that applying a *probability factor* of 28% discounts a *potential redress liability*, or a group of them, by more than what is reasonable.

(2) Where this *rule* applies, a *firm* must either:

(a) apply no *probability factor* to the relevant *potential redress liabilities*; or

(b) apply a reasonable *probability factor* that results in less of a discount than under *IPRU-INV* 13.16.26R.

13.16.28 G (1) The *probability factor* is intended to reflect:

(a) that not all outstanding *complaints* result in obligations to provide redress or remediation – many *complaints* are rejected; and

(b) that not all *prospective redress liabilities* will necessarily result in an obligation to provide redress or remediation – for example, a *firm* may investigate the relevant issues further and conclude that it is not appropriate to provide redress or remediation.

(2) *IPRU-INV* 13.16.26R applies a default *probability factor* of 28% because the *FCA* recognises that most *firms* are likely to find it challenging, time-consuming and disproportionately expensive to calculate their own discount with any degree of precision.

(3) However, *IPRU-INV* 13.16.27R requires that if a *firm* has reasonable grounds to believe that the default *probability factor* discounts a *potential redress liability*, or a group of them, by more than what is reasonable, the *firm* must not apply the *probability factor*, or apply one that results in less of a discount.

(4) A *firm* may recognise some redress liabilities under ordinary accounting principles in a way that reduces its capital resources. In this case, *IPRU-INV* 13.16.5R may apply, and the *firm* may disregard the liabilities for the purposes of this chapter.

(5) If a *firm* believes that it should be allowed to apply more of a discount than 28%, for example because a high proportion of its *complaints* are frivolous or vexatious, it may apply to the *FCA* for a waiver or modification. The process for a waiver or modification is set out in *SUP* 8.

13.16.29 G The following example illustrates how a *firm* may apply the *probability factor* in accordance with *IPRU-INV* 13.16.26R and *IPRU-INV* 13.16.27R.

(1) A *firm* ('Firm X') has identified 20 *unresolved redress liabilities*. Firm X estimates an amount per *complaint* of £500.

(2) Firm X has also identified 3 *prospective redress liabilities* through its complaints monitoring that relate to unsuitable advice and involve potentially large losses to customers. Firm X has already investigated the *prospective redress liabilities*, and considers that it will need to provide redress, although these liabilities have not yet been reflected in the *firm's* financial statements in a way that reduces its capital resources. Firm X estimates amounts of £40,000, £60,000 and £80,000 for the 3 *prospective redress liabilities*.

(3) As Firm X has already investigated the *prospective redress liabilities* and considers that it will need to provide redress, Firm X recognises that applying any *probability factor* would be unreasonable. Firm X therefore does not apply the *probability factor* to the 3 *prospective redress liabilities*.

(4) However, Firm X may still apply the *probability factor* to the 20 *unresolved redress liabilities* estimated at £500 each, because it is not yet clear whether the relevant *complaints* will be upheld.

(5) Firm X calculates its overall *capital deduction for redress* as (£40,000 + £60,000 + £80,000) + (20 × £500 × 28%) = £182,800

Setting aside resources potential redress liabilities

13.16.30 G (1) *IPRU-INV* 13.16.8R requires a *firm* to set aside capital resources for its *potential redress liabilities*.

(2) The amount that a *firm* sets aside under (1) must be subtracted from a *firm's* capital resources in accordance with *IPRU-INV* 13.15.3R.

(3) *IPRU-INV* 13.1.4R(1) requires a *firm* to have and maintain capital resources at least equal to its relevant capital resources requirement. The capital resources requirement is contained in *IPRU-INV* 13.13. The effect of *IPRU-INV* 13.1.4R(1) is that a *firm* must not carry out any transaction which would cause its capital resources (after accounting for the *capital deduction for redress*) to fall below its capital resources requirement.

(4) In the event that a *firm* with *potential redress liabilities* nevertheless falls below its capital resources requirement, the *firm* must comply with the *asset retention requirement i*n *IPRU-INV* 13.17. These requirements are intended to preserve and improve the *firm's* capital position over time, so that it is better able to meet *potential redress liabilities*.

How frequently must a firm identify and quantify its potential redress liabilities under IPRU-INV 13.16?

13.16.31 G (1) *IPRU-INV* 13.1.4R(1) requires a *firm* to maintain capital resources at least equal to its relevant capital resources requirement at all times.

(2) However, the frequency with which the *FCA* expects a *firm* to repeat the identification and quantification of *potential redress liabilities* will depend on the *firm's* specific circumstances.

(3) If a *firm* has a significant excess of capital resources, and has no new information about *potential redress liabilities* that could be material, it may be sufficient for it to update the identification and quantification of *potential redress liabilities* as part of its regular financial accounting cycle.

(4) However, to comply with *IPRU-INV* 13.1.4R, a *firm* should also identify and quantify its *potential redress liabilities* outside of its regular financial accounting cycle as soon as it becomes aware of new information that could be material to its financial position (e.g. it becomes aware of material new *potential redress liabilities*, or it becomes aware that its professional indemnity insurance may be materially amended or may not be renewed).

(5) *IPRU-INV* 13.17.8R requires a *firm* that has *potential redress liabilities* and falls below its capital resources requirement to notify the *FCA* immediately. Such a *firm* must comply with the *asset retention requirement*.

13.17 Asset retention requirement

Purpose of the asset retention requirement

13.17.1 G (1) The purpose of the *asset retention requirement* is to:

(a) ensure that a *firm* increases its capital resources to the level it must hold to comply with its capital resources requirement;

(b) maximise a *firm's* ability to pay for *potential redress liabilities*;

(c) prevent a *firm* from undertaking transactions that are not in the ordinary course of business; and

(d) facilitate the orderly wind-down of the business where a *firm* fails to meet its crystallised redress liabilities.

(2) The *asset retention requirement* is designed to interfere with a *firm's* ability to transact in its assets only to the extent necessary to ensure that the *firm* meets its capital resources requirement and can pay for any *potential redress liabilities*.

(3) If a *firm* identifies that it will not be able to meet its capital resources requirement after deducting any *potential redress liabilities* using the methodology set out in the *rules* and *guidance* in *IPRU-INV* 13.16, then the *asset retention requirement* prevents the *firm* from carrying out any transaction unless the transaction is in the ordinary course of business.

(4) The *FCA* has made *rules* and *guidance* in *IPRU-INV* 13.17.12R to *IPRU-INV* 13.17.22G about what the ordinary course of business means. The *FCA* expects that these will generally be sufficient to allow a *firm* to interpret the *asset retention requirement*. On occasion, however, a *firm* may feel the need to seek individual *guidance* from the *FCA*. Further information on seeking individual *guidance* is contained in *SUP* 9.

(5) Where a *firm* wishes to carry out a transaction that is in the ordinary course of business but is not listed in *IPRU-INV* 13.17.12R(1), the *firm* must first notify the *FCA* in accordance with *IPRU-INV* 13.17.16R(1)(a).

When the asset retention requirement applies

13.17.2 R The *asset retention requirement* applies to a *firm*:

(1) that:

(a) has a *potential redress liability* under *IPRU-INV* 13.16; or

(b) would have a *potential redress liability* for the purposes of *IPRU-INV* 13.16 if it were not for the application of *IPRU-INV* 13.16.5R; and

(2) that concludes that the *firm* is below its capital resources requirement.

13.17.3 R The *asset retention requirement* does not apply to any of the following:

(1) a *firm* that:

(a) is part of an *investment firm group* under *MIFIDPRU* 2 that operates an *ICARA process* on a *consolidated basis*, as described in *MIFIDPRU* 7.9.4G; and

(b) has notified the *FCA* in accordance with *IPRU-INV* 13.16.2R(1)(b);

(2) a *firm* that:

(a) is part of a group supervised under Chapter 2 of Title II of Part One of the *UK CRR* or the Solvency II Firms: Group Supervision part of the *PRA Rulebook*;

(b) operates a group risk assessment process which achieves equivalent outcomes to an *ICARA process* operated on a *consolidated basis*; and

(c) has notified the *FCA* in accordance with *IPRU-INV* 13.16.2R(2)(c);

(3) a *firm* that is a natural person or a *partnership* involving one or more natural persons;

(4) a *firm* that is subject to an *insolvency order*;

(5) a *firm* that is in a creditors' voluntary winding up under Chapter IV of Part IV of the Insolvency Act 1986; and

(6) a *firm* that is subject to an asset retention requirement under section 55L of the *Act* that has comparable effect to the *asset retention requirement*.

13.17.4 R The *asset retention requirement* applies as soon as a *firm* with *potential redress liabilities* under *IPRU-INV* 13.16 concludes that it is not meeting its capital resources requirement.

13.17.5 G (1) When determining whether the *asset retention requirement* applies, *firms* should account for the *capital deduction for redress* as required by *IPRU-INV* 13.15.3R.

(2) *IPRU-INV* 13.16.5R explains that a *firm* may disregard a redress liability for the purposes of *IPRU-INV* 13.16 where that liability has already been recognised in its financial statements in accordance with the relevant accounting principles, and the *firm's* capital resources have been reduced as result. This is to avoid double-counting.

(3) *IPRU-INV* 13.17.2R(1)(b), however, makes clear that the *asset retention requirement* may apply whether a *firm* has a *potential redress liability* for purposes of *IPRU-INV* 13.16 or has a redress liability that it has recognised in accordance with the relevant accounting principles.

(4) The rationale for this approach is that the *asset retention requirement* is designed to prevent asset dissipation by undercapitalised *firms*. This need to prevent assets being dissipated applies both when a *firm* is undercapitalised because it has made a *capital deduction for redress* and when it is undercapitalised because it has recognised a redress liability in its financial statements.

The asset retention requirement

13.17.6 R A *firm* that is subject to the *asset retention requirement* must not in any way dispose of, withdraw, transfer, deal with or diminish the value of any of its own assets (whether in the *United Kingdom* or elsewhere), unless the relevant transaction occurs in the ordinary course of business.

13.17.7 G (1) *IPRU-INV* 13.17.6R contains the *asset retention requirement* that prevents a *firm* from undertaking transactions that could have the effect of dissipating the value of the *firm's* assets.

(2) Under *IPRU-INV* 13.17.6R, the *asset retention requirement* does not apply to a transaction that a *firm* undertakes in the ordinary course of business. *IPRU-INV* 13.17.12R(1) contains a non-exhaustive list of transactions that a *firm* may treat as being undertaken in the ordinary course of business for these purposes. *IPRU-INV* 13.17.21R contains a list of transactions that a *firm* must not treat as being undertaken in the ordinary course of business.

Requirement to notify the FCA when the asset retention requirement applies

13.17.8 R (1) A *firm* must notify the *FCA* immediately that the *asset retention requirement* applies to it.

(2) Where a *firm* has notified the *FCA* as required by this section, it is deemed to have complied with the provisions of *SUP* 15.3.1R.

(3) A *firm* must notify the *FCA*:

(a) by completing the relevant section of *RMAR*, unless doing so would prevent the *firm* notifying the *FCA* immediately; or

(b) in any other case, by submitting the notification form in *SUP* 15 Annex 4.

(4) The notification in (3)(b) must:

(a) specify that the notification relates to *IPRU-INV* 13.17.8R(1);

(b) be sent:

(i) through online submission on the *FCA's* website; [*Editor's note*: *firms* will be able to use the website for this purpose in or after December 2023] or

(ii) by electronic mail to the *firm's* usual supervisory contact; and

(c) include information showing how the *firm* performed the calculation of its capital resources under *IPRU-INV* 13.15.3R.

13.17.9 G The effect of *IPRU-INV* 13.17.4R is that the date on which a *firm* submits the notification under *IPRU-INV* 13.17.8R(1), or receives a response from the *FCA* regarding such notification, is not relevant for the purposes of compliance with the *asset retention requirement*.

Lifting the asset retention requirement

13.17.10 R (1) A *firm* that wishes to lift the *asset retention requirement* must notify the *FCA* that it is meeting its capital resources requirement.

(2) A *firm* must notify the *FCA*:

(a) by completing the relevant section of the *RMAR*, unless doing so would delay the *firm* notifying the *FCA*; or

(b) in any other case, by submitting the notification form in *SUP* 15 Annex 4.

(3) The notification in *IPRU-INV* 13.17.10R(2)(b) must:

(a) specify that the notification relates to *IPRU-INV* 13.17.10R(1).

(b) be sent:

(i) through online submission on the *FCA's* website; [*Editor's note*: firms will be able to use the website for this purpose in or after December 2023] or

(ii) by electronic mail to the *firm's* usual supervisory contact; and

(c) include information showing how the *firm* performed the calculation of its capital resources under *IPRU-INV* 13.15.3R.

13.17.11 R (1) The *asset retention requirement* will (save in the circumstances in *IPRU-INV* 13.17.11R(2)) cease to apply at the end of the period specified in (3).

(2) The *asset retention requirement* will continue to apply if, within the periods specified in *IPRU-INV* 13.17.11R(3), the *FCA* has:

(a) asked the *firm* to provide further information; or

(b) notified the *firm* that it does not agree that the *firm* is meeting its capital resources requirement.

(3) The period specified for the purpose of (1) and (2) ends:

(a) 20 *business days* after the day on which the *firm* submitted the notification in *IPRU-INV* 13.17.10R(1); or

(b) where the *FCA* has asked the *firm* to provide further information, 20 *business days* after the day on which the *firm* submitted that information.

Transactions in the ordinary course of business

13.17.12 R (1) The following is a non-exhaustive list of transactions that a *firm* may treat as occurring in the ordinary course of business for the purposes of *IPRU-INV* 13.17.6R:

(a) transactions giving effect to instructions initiated by customers;

(b) payments to, or other transactions with, the *firm's* counterparties in the ordinary course of operating the *firm's* business and in satisfaction of the *firm's* contractual obligations;

(c) usual and proper contractual salary payments or payments made in connection with obligations owed to *employee* pension schemes;

(d) payment of dividends or drawings that have been approved by the *FCA* in accordance with *IPRU-INV* 13.17.13R;

(e) payments connected to reasonable legal expenses and other reasonable expenses incurred in relation to obtaining accounting or audit advice; and

(f) payments connected to the *firm's* tax or regulatory obligations, including any payments of redress.

(2) Where a *firm* intends to undertake a transaction that the *firm* considers is in the ordinary course of business, but which is not a type of transaction listed in *IPRU-INV* 13.17.12R(1), the *firm* must notify the *FCA* in advance under *IPRU-INV* 13.17.16R.

Payment of dividends and LLP members' drawings

13.17.13 R (1) A *firm* may treat a dividend as being paid in the ordinary course of business for the purposes of *IPRU-INV* 13.17.6R if the *firm* has obtained prior express consent from the *FCA*.

(2) A request for the consent referred in *IPRU-INV* 13.17.13R(1), must include the following information:

(a) the value of the proposed dividend(s);

(b) the date on which the *firm* intends to pay the proposed dividend(s);

(c) the recipient(s) of the proposed dividend(s);

(d) a clear statement of the quantified effect of the payment of the proposed dividend(s) on the *firm's* regulatory capital position;

(e) a copy of the *firm's* latest management accounts; and

(f) an express confirmation that the payment of the proposed dividend(s) is lawful under applicable company or partnership law and insolvency law.

(3) As part of the request for consent in *IPRU-INV* 13.17.13R(1), a *firm* must demonstrate both of the following to the reasonable satisfaction of the *FCA*:

(a) the dividend(s) will be paid in connection with services provided for, or on behalf of, the *firm* by a natural person; and

(b) the timing of the proposed payment, and the value of the dividend(s), are consistent with the historical pattern of the payment of dividends for equivalent purposes over the immediately preceding 12 *months*.

(4) The request for consent under *IPRU-INV* 13.17.13R(1) must:

(a) be made using the form in *SUP* 15 Annex 4;

(b) specify that it relates to *IPRU-INV* 13.17.13(1); and

(c) be sent:

(i) through online submission on the *FCA's* website; [*Editor's note*: firms will be able to use the website for this purpose in or after December 2023] or

(ii) by electronic mail to the *firm's* usual supervisory contact.

(5) For the purposes of this *rule*, a reference to a 'dividend' includes drawings paid to a member of a *limited liability partnership*.

13.17.14 G The purpose of *IPRU-INV* 13.17.13R(1) is to permit a *firm* that is subject to the *asset retention requirement* to pay dividends or drawings to individual shareholders or members where those individuals perform services for the *firm* and have historically been paid through similar dividends or drawings, and where prior *FCA* consent to the dividends or drawings has been obtained. Any dividends or drawings paid must be consistent in terms of both their value and their timing with previous dividends or drawings paid by the *firm* for that purpose. The *firm* must also confirm to the *FCA* that the payment of the dividend or drawings would be lawful, having regard to any relevant restrictions that may apply in areas such as company law or insolvency law. A *firm* may wish to obtain professional advice to confirm its analysis before giving the required confirmation.

13.17.15 G (1) As part of the request for consent in *IPRU-INV* 13.17.13R(1), a *firm* is required to include a clear statement of the quantified effect of the payment of the proposed dividend(s) on the *firm's*

regulatory capital position. A *firm* should provide this information by:

(a) providing financial forecasts which show the expected change in the *firm's* regulatory capital over time; and

(b) explaining the impact of proposed dividend payments on these financial forecasts.

(2) When quantifying a proposed dividend payment, the *FCA* expects a *firm* to consider its regulatory obligations under the *threshold conditions* and the *principles*. Dividend payments which allow a *firm* to increase its regulatory capital over time, and which support the *firm* in setting aside resources for *potential redress liabilities* over a reasonable time horizon, would support compliance with these obligations.

Prior notification of other transactions in the ordinary course of business

13.17.16 R (1) Except where *IPRU-INV* 13.17.16R(2) applies, a *firm* must notify the *FCA* at least 20 *business days* in advance of:

(a) undertaking any transaction that the *firm* considers is in the ordinary course of business, but which is not listed in *IPRU-INV* 13.17.12R(1); or

(b) any change to its contracts with *connected persons* (including both variation of existing contracts and entry into new or replacement contracts) which could result in new or increased payments above the de minimis threshold specified in *IPRU-INV* 13.17.18R(1).

(2) If a *firm* needs to undertake a transaction or change in contracts that falls within *IPRU-INV* 13.17.16R(1) in an urgent situation, the *firm* must still notify the *FCA* in advance by giving as much notice as possible, but the 20-*business day period* in *IPRU-INV* 13.17.16R(1) does not apply.

13.17.17 G The *FCA* expects that a *firm* would make a notification of the type specified in *IPRU-INV* 13.17.16R(2) only in genuinely urgent cases and where it has not been possible to identify the need for the relevant transaction sufficiently in advance. In such cases, the *firm* must still give the *FCA* as much notice as possible.

13.17.18 R (1) The de minimis threshold referred to in *IPRU-INV* 13.17.16R(1)(b) is a percentage amount equal to the latest Consumer Price Index annual rate published by the Office for

National Statistics at the time at which the change in contract is proposed to occur.

(2) In calculating whether the de minimis threshold has been exceeded, a *firm* must aggregate all connected payments.

13.17.19 G For the purposes of *IPRU-INV* 13.17.18R(2), payments may be connected because they are made to the same *person*, or because they are made to separate *persons* who are connected by virtue of being *close relatives*, or through an agent-principal relationship or through a relationship of control.

13.17.20 R (1) The notification in *IPRU-INV* 13.17.16R(1) and *IPRU-INV* 13.17.16R(2) must:

(a) be made using the form in *SUP* 15 Annex 4;

(b) specify whether the notification relates to *IPRU-INV* 13.17.16R(1) or *IPRU-INV* 13.17.16R(2); and

(c) be sent:

(i) through online submission on the *FCA's* website; [*Editor's note*: firms will be able to use the website for this purpose in or after December 2023] or

(ii) by electronic mail to the *firm's* usual supervisory contact; and

(2) contain the following information:

(a) an explanation of the transaction or contract change;

(b) an explanation of the quantifiable impact on the *firm's* regulatory capital position;

(c) an explanation of why the *firm* considers that the transaction or contract change occurs in the ordinary course of business, and is therefore permitted;

(d) reference to any comparable historic payments or contract changes which support the *firm's* view that this occurs in the ordinary course of business; and

(e) in the case of a notification on an urgent basis under *IPRU-INV* 13.17.16R(2), an explanation of the nature of the urgency and why it has not been possible to comply with the normal 20-*business day* notification requirement in *IPRU-INV* 13.17.16R(1).

Transactions not in the ordinary course of business

13.17.21 R The following transactions must not be regarded as occurring in the ordinary course of business:

(1) payments to any *connected person*, except to the extent that they fall within a category of transaction listed in *IPRU-INV* 13.17.12R(1);

(2) the making of any capital distributions, dividend payments or payment of drawings, except to the extent expressly permitted by the *FCA* under *IPRU-INV* 13.17.12R(1)(d) and *IPRU-INV* 13.17.13R;

(3) the making of any gift or loan;

(4) any payments or transfers made as part of any financial restructuring or reorganisation of the *firm's* business (whether share or asset based) or the acquisition by the *firm* of part or all of another business; and

(5) the disposal to another *person* of some or all of the *firm's* client files or ongoing income from the client bank.

13.17.22 G The effect of *IPRU-INV* 13.17.6R is that if a *firm* is subject to the *asset retention requirement*, it must not undertake any of the types of transactions listed in *IPRU-INV* 13.17.21R.

The remediation plan

13.17.23 G (1) The *FCA* will generally expect a *firm* that notifies that it is subject to an *asset retention requirement* to submit a plan setting out how it intends to remediate the breach of its capital resources requirement (the remediation plan). This would be communicated to the *firm* through the usual supervisory channels.

(2) The *FCA* will usually expect a *firm* to provide its remediation plan within 10 *business days* of the *FCA's* request.

(3) The following are examples of information and documents that may be requested for the remediation plan:

(a) the cause of the *potential redress liabilities*;

(b) details of relevant professional indemnity insurance coverage;

(c) an explanation of why the *firm* is below its capital resources requirement;

(d) the remediation plan;

(e) the timeframe within which the *firm* plans to remediate the breach of the capital resources requirement; and

(f) the *firm's* business plan and wind-down plan.

13.18 Supplementary material

The FCA's supervisory approach

13.18.1 G (1) *Firms* are required to report data, including data on their financial position and *potential redress liabilities*, through the *RMAR*.

(2) The *FCA* will use this and other information it receives to direct its supervisory attention.

(3) The *FCA* may request further information about a *firm's* financial position, financial projections or its compliance with the requirements of this chapter (e.g. its identification and quantification of *potential redress liabilities*).

(4) As set out in *IPRU-INV* 13.1.2G, the requirements in this chapter are designed to amplify *threshold condition* 2D (Appropriate resources) and *Principles* 3 and 4. However, the specific *rules* should not be taken as exhausting the application of the *threshold conditions* or the *Principles*.

(5) The *FCA* may take such further supervisory action as it considers appropriate to supplement the requirements in this chapter in the advancement of its *operational objectives* or to ensure that a *firm* meets the *threshold conditions*, including by:

(a) requiring a *firm* to hold additional capital resources;

(b) requiring a *firm* to:

(i) recognise particular matters as *potential redress liabilities*;

(ii) quantify those liabilities using a particular methodology; or

(iii) set aside financial resources to meet those liabilities (including by ringfencing cash or other liquid assets);

(c) requiring a *firm* to comply with the *asset retention requirement* in *IPRU-INV* 13.17 or similar requirements, irrespective of whether the conditions in *IPRU-INV* 13.17.2R are met;

(d) requiring a *firm* to reduce or limit the amount of variable remuneration it pays;

(e) requiring a *firm* to reduce or limit its distributions of profits;

(f) imposing additional or more frequent reporting requirements;

(g) requiring a *firm* to implement new risk management or governance arrangements;

(h) restricting the activities that a *firm* may undertake as part of its business (which may be on a permanent basis, for a specified period of time, or until certain specified conditions are met); or

(i) giving individual *guidance* to the *firm* on any of the above matters or on any other matter that the *FCA* considers is relevant.

(6) The *FCA* would normally expect to take the actions described in (5) by using one or more of the following approaches:

(a) exercising the powers under section 55J of the *Act* permitting the *FCA* to vary or cancel a *firm's permission*;

(b) inviting a *firm* to make a voluntary application for the imposition of a requirement under section 55L(5) of the Act;

(c) imposing a *requirement* on a *firm* on the *FCA's* own initiative under section 55L(3) of the Act;

(d) requiring a report by a *skilled person* in accordance with section 166 of the *Act*; or

(e) giving individual guidance to a *firm* under section 139A of the *Act*, as further described in *SUP* 9.3.

Responsibilities of SMF managers and other individuals

13.18.2 G (1) The *FCA* reminds *SMF managers* that they are personally accountable for breach of the conduct rules in *COCON*. For example, Senior Manager Conduct Rule 2 (*COCON* 2.2.2R) requires an *SMF manager* to take reasonable steps to ensure that the business of the *firm* for which they are responsible complies with the relevant requirements and standards of the *regulatory system*.

(2) The *FCA* also reminds *SMF managers* and other individuals involved in the affairs of a *firm* that any *person* knowingly concerned in the breach of a regulatory

requirement may be required to pay restitution under section 382 of *FSMA*.

(3) Where a *firm* has failed to comply with regulatory requirements (for example, because it has failed to properly identify, quantify or set aside capital resources for *potential redress liabilities* under *IPRU-INV* 13.16), and that failure has led to the *firm* being unable or less able to pay redress, the *FCA* may take action to fine or recover appropriate amounts from the *SMF managers* or other individuals concerned.

Amend the following as shown. Underlining indicates new text and striking through indicates deleted text.

TP 1 Table: Transitional provisions applying to IPRU(INV)

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
…					
23	…	…	…	…	…
24	*IPRU-INV* 13.16 and *IPRU-INV* 13.17	R	The obligations in *IPRU-INV* 13.16 and *IPRU-INV* 13.17 (and therefore the need to apply the *capital deduction for redress* in *IPRU-INV* 13.15.3R) do not apply until a *firm's* first due date for Section D1 of the *RMAR* (as calculated in accordance	From [*date*] until [*date*]	[*date*]

			with *SUP* 16.12) that occurs on or after [*date*]		

Annex D

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text.

16 Reporting requirements

…

16 Annex 18A Retail Mediation Activities Return ('RMAR')

…

SECTION D1: Regulatory Capital

…

Capital resources per MIPRU 4 (home finance and non-investment insurance intermediation)

Incorporated firms

…		
31	…	
31A	(if also subject to IPRU-INV 13.16) **less** capital deduction for redress	
…		

Unincorporated firms and limited liability partnerships

…		
38	…	
38A	(if subject to IPRU-INV 13.16) **less** capital deduction for redress	
…		

Personal investment firm - capital resources per IPRU(INV) 13

…		
50	…	
50A	(if subject to IPRU-INV 13.16) Less capital deduction for redress	

…

55	**CAPITAL RESOURCES**	

Personal investment firm - breakdown of capital deduction for redress per IPRU-INV 13.16

56	Number of customers impacted by unresolved redress liabilities	
57	Value of all unresolved redress liabilities (£) after reduction for professional indemnity insurance but before applying the probability factor	
58	Number of customers impacted by prospective redress liabilities	
59	Value of all prospective redress liabilities (£) after reduction for professional indemnity insurance but before applying the probability factor	
60	Whether professional indemnity insurance has been used to offset the amounts in 57 or 59 (Y/N)	
61	Total amount offset through professional indemnity insurance before applying the probability factor (£)	

16 Annex 18BG **Notes for Completion of the Retail Mediation Activities Return ('RMAR')**

…

Section D Regulatory Capital

…

'Higher of' requirements

In this section there are separate calculations of regulatory capital and capital resources requirements for the different types of business covered by the data requirements. The calculations are the same, however, for both *home finance mediation activity* and *insurance distribution activity* relating to *non-investment insurance contracts*.

…

(iii) For such a *firm* that is also subject to *IPRU(INV)* 13, the requirement is as computed in *IPRU-INV* 13.13.3R and is compared with the higher of the two capital resources calculations (see *MIPRU* 4.4.1R) subject to an adjustment for the *capital deduction for redress*.

…

Guide for completion of individual fields

…	
Home finance mediation and non-investment insurance distribution	
…	
Capital resources	This should be the capital resources calculated in accordance with *MIPRU* 4 for incorporated or unincorporated *firms* as applicable. For *firms* that are additionally subject to Chapter 3 or 5 of *IPRU(INV)* or *MIFIDPRU*, this should be the higher of the capital resources per *MIPRU* 4 and the financial resources determined by *IPRU(INV)* or *MIFIDPRU*. For *firms* that are additionally subject to *IPRU-INV* 13, this should be the higher of the capital

	resources per *MIPRU* 4 less the *capital deduction for redress* and the financial resources determined by *IPRU(INV)* 13. See *MIPRU* 4.4.1R.
…	
Capital resources per MIPRU 4 (home finance mediation activity and non-investment insurance distribution activity)	
Incorporated firms	
…	
Less intangible assets	Any amounts recorded as intangible assets in section A above should be entered here for deduction.
(If subject to *IPRU-INV* 13.16) **less** *capital deduction for redress*	If the *firm* is also subject to *IPRU-INV* 13.16, the amount entered here should reflect the *capital deduction for redress* calculated under *IPRU-INV* 13.16. If the *firm* is not subject to *IPRU-INV* 13.16, this field should be left blank.
Unincorporated firms and limited liability partnerships	
…	
Less excess of drawings over profits for a sole trader or partnership or LLP	Any excess of drawings over profits should be calculated in relation to the period following the date as at which the capital resources are being calculated. The figures do not have to be audited to be included.
(If subject to *IPRU-INV* 13.16) **less** *capital deduction for redress*	If the firm is also subject to *IPRU-INV* 13.16, the amount entered here should reflect the *capital deduction for redress* calculated under *IPRU-INV* 13.16. If the firm is not subject to *IPRU-INV* 13.16, this field should be left blank.

Capital resources per IPRU(INV) 13.15.3R	
IPRU(INV) requires that all *personal investment firms* have financial resources of at least £20,000 at all times. This section is designed to evaluate *firms'* adherence to this requirement. The amounts entered here should be in accordance with *IPRU-INV* 13.15.3R.	
Personal investment firm – breakdown of capital deduction for redress per IPRU(INV) 13.16	
This section requires *personal investment firms* to enter a breakdown of how they have arrived at the *capital deduction for redress* entered in 50A. *Firms* that are part of prudentially supervised groups may be exempt from the *capital deduction for redress* under *IPRU-INV* 13.16.2R, in which case the relevant fields should be left blank.	
Number of customers impacted by *unresolved redress liabilities*	This should be the total number of customers impacted by *unresolved redress liabilities*. *Firms* should not include any *unresolved redress liabilities* that have ceased to exist by the end of the reporting period (i.e. because the relevant *complaint* has been resolved and there is no realistic prospect of it being reopened (*IPRU-INV* 13.16.13R). Similarly, *firms* should not include any *unresolved redress liabilities* that are already recognised in its financial statements in accordance with the relevant accounting principles in a way that already reduces their available capital resources (*IPRU-INV* 13.16.5R).
Value of all *unresolved redress liabilities* (£) after reduction for professional indemnity insurance but before applying the *probability factor*	This should be the sum of the amounts quantified for each *unresolved redress liability*, after the application of any reduction for professional indemnity insurance (*IPRU-INV* 13.16.24R), but before applying the *probability factor* (*IPRU-INV* 13.16.26R and 13.16.27R).
Number of customers impacted by *prospective redress liabilities*	This should be the total number of *prospective redress liabilities* a *firm* identifies at the end of the reporting period (i.e. the total number of customers affected by all *prospective redress liabilities*).

	Firms should not include any *prospective redress liabilities* that have ceased to exist by the end of the reporting period (i.e. because the relevant *prospective redress liability* has been resolved and there is no realistic prospect of it being reopened (*IPRU-INV* 13.16.18R). Similarly, *firms* should not include any *prospective redress liabilities* that are already recognised in their financial statements in accordance with the relevant accounting principles that have already reduced their available capital resources (*IPRU-INV* 13.16.5R).
Value of all *prospective redress liabilities* (£) after reduction for professional indemnity insurance but before applying the *probability factor*	This should be the sum of the amounts quantified for each *prospective redress liability*, after the application of any reduction for professional indemnity insurance (*IPRU-INV* 13.16.24R) but before applying the *probability factor* (*IPRU-INV* 13.16.26R and 13.16.27R)
Whether professional indemnity insurance has been used to offset the amounts in 57 and/or 59 (Y/N)	*Firms* should respond Y if professional indemnity insurance has been relied upon to reduce any of the amounts identified.
Total amount offset through professional indemnity insurance before applying the *probability factor* (£)	*Firms* should provide the total amount offset through professional indemnity insurance (i.e. the difference between the total amount the *firm* quantified for all *potential redress liabilities*, and the amount the *firm* would have had to quantify were there no professional indemnity insurance policy) This should be calculated before applying the *probability factor* (*IPRU-INV* 13.16.26R and 13.16.27R).

…

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