Summary of the New 2015 Social Housing Regulatory Framework

Executive Summary

This paper provides an outline of the key changes to the HCA's regulatory framework and provides a brief analysis of what this means for our sector. A number of the changes to the framework relate to good business practice and some are new. Work is continuing to assess the revised framework particularly as more detail becomes available to help us to better understand our compliance against the new requirements.

It is clear that the proposals from the HCA build on the existing co-regulatory approach and include more focused requirements for registered providers (RPs) to ensure they effectively manage their risks and have the appropriate skills and capabilities both at Board and Executive levels to meet their objectives.

It is the Governance and Financial Viability standard that this paper focuses on. However it is important to note that compliance with consumer standards remains a high priority for the Regulator even though these are not proactively regulated. This is evidenced through the increasing number of downgrades from the Regulator which relate to non-compliance with consumer standards by applying the serious detriment test, such as maintenance service failings and gas servicing non-compliance. Further details of this are included at paragraph Appendix A.

The strategic impacts to RPs of the new regulatory framework are:

- ✓ Renewed emphasis on governance and leadership, including skills and experience to understand their business and the impact of their decisions. *Successes and failures of a business will 'lie squarely at the feet' of Management and Boards.*
- ✓ Development and implementation of multivariate stress testing, more robust risk management strategies and an assets and liabilities register.
- ✓ Proactive relationship and engagement with the HCA. *The Regulator expects open dialogue when the standards are not achieved or will not be achieved.*
- ✓ Greater rigour around operational and financial performance. *It is now clear that performance is a primary driver for the HCA to assess RPs; be it through financial or service delivery.*
- ✓ Money flows within a Group structure from social activities to non-social activities. *The primary objective of the framework is to protect social housing assets.*
- ✓ Collective responsibility for RPs to protect the reputation of the sector. *This is important as the sector has benefitted financially from being in a regulated sector.*
- ✓ Formalised sign off by the Boards on a number of key areas. *This is very much about Boards taking overt ownership of their responsibilities.*

The Regulator has identified four pillars of regulatory activity with RPs 'on the ground':

1. **Quarterly Survey** – to continually gather specific information about RPs and gauge any potential red flags

2. **Reactive Engagement** – for any potential matters or problems which may arise

3. **In Depth Assessments** (IDAs) - IDAs will be used as a fairly intrusive engagement to get a grip on the risk profile of an organisation, its exposures and the quality of governance to understand and manage these risks. Our understanding currently is that, providers over 1000 units will have an IDA every 4 years and some larger more complex organisations may have them every 2 years.

4. **Annual Stability checks** - the Annual Stability Checks will look at strategy, structure, financial resilience and risk profile, particularly the management and control of risk. This will include how committees work and how they feed back to the parent.

Recent discussions with the Regulator indicate that formal IDAs will not commence until later in 2015-16. The HCA are seeking about 10 RPs to volunteer for a pilot.

In summary the HCA have published a revised Governance & Financial Viability Standard and a Code of Practice which is designed to enhance our understanding of the main framework. Section 2 of Appendix A provides a high level position statement against the new code.

Contact Amandeep Jhawar, Audit Director today to discuss the new regulatory framework in more detail and find out what it practically means for your business: Aman.Jhawar@ServiceMatters.uk.com or 024 7643 8150.

APPENDIX A

1.0 Downgrades & Revised Regulatory Framework

1.1 The revised Regulatory Framework has introduced specific expectations for Registered providers and in turn has led to a more rigorous assessment by the Regulator, which has been evidenced through recent down grading of previously G1 and V1 organisations.

1.2 The approach by the HCA is very much aligned to the journey that other regulatory bodies have undertaken (i.e. OFSTED and the Care Quality Commission) whereby top grades are seen as the exception and therefore reasonable to assume that Registered providers will have to 'work harder' than previously to receive G1 and V1 ratings.

1.3 Although the increasing number of downgrades since 1 April 2014 is not a 'secret', it is interesting to note the expanding reasons leading to the downgrades:

1. Serious detriment due to gas failures.
2. Serious detriment due to failing maintenance service.
3. Failure to submit regulatory returns within agreed timescales.
4. Poor examples of VFM assessments being submitted.
5. Breach of financial covenants.
6. Payments not being authorised in line with governing documents impact upon conflict of interest at Board level.
7. Exposure to the housing market as part of its development programme.
8. Financial plan has significant reliance upon outright sales and shared ownership.
9. Falsifying documentation in order to draw down grant ahead of practical completion.
10. Poor risk planning specifically in terms of scenario planning and stress testing.

1.4 The revised regulatory framework is expected to support RPs to run effective businesses by supporting the promotion of good business practice, early warning signals and appropriate expertise & engagement by boards. This is all encompassed in a revised Governance & Financial Viability Standard supported by a code of practice which seeks to enhance the standards

1.5 The 'on the ground' regulatory activity will incorporate 4 strands:

5. Quarterly Survey
6. Reactive Engagement
7. In Depth Assessments
8. Annual Stability checks

2.0 Key expectations from the revised framework

2.1 Registered providers shall adopt and comply with an appropriate code of governance. Governance arrangements should establish and maintain clear roles, responsibilities and accountabilities for the board, chair and chief executive and ensure appropriate probity arrangements are in place. Areas of non-compliance with their chosen code of governance should be explained. Registered providers should assess the effectiveness of their governance arrangements at least once a year.

Many RP's have adopted the NHF Code of Governance, compliance against which is assessed on an annual basis with non compliance reported separately.

2.2 Registered providers shall communicate in a timely manner with the regulator on material issues that relate to non-compliance or potential non-compliance with the standards.

It is important for RP's to maintain strong relationship with the Regulators, with any issues of non compliance being communicated with the HCA.

2.3 Registered providers shall ensure that they have an appropriate, robust and prudent business planning, risk and control framework. The framework shall ensure:

- ✓ there is access to sufficient liquidity at all times
- ✓ financial forecasts are based on appropriate and reasonable assumptions
- ✓ effective systems are in place to monitor and accurately report delivery of the registered provider's plans
- ✓ the financial and other implications of risks to the delivery of plans are considered
- ✓ registered providers monitor, report on and comply with their funders' covenants

The framework shall be approved by the registered provider's board and its effectiveness in achieving the required outcomes shall be reviewed at least once a year.

RP's require well developed business planning and risk framework, which are reviewed each year. Although the outcomes from the framework are presented to the Boards, in future the Board will be asked to approve the framework itself.

2.4 Registered providers shall assess, manage and where appropriate address risks to ensure the long term viability of the registered provider, including ensuring that social housing assets are protected. Registered providers shall do so by:

a) maintaining a thorough, accurate and up to date record of their assets and liabilities and particularly those liabilities that may have recourse to social housing assets
b) carrying out detailed and robust stress testing against identified risks and combinations of risks across a range of scenarios and putting appropriate mitigation strategies in place as a result

c) before taking on new liabilities, ensuring that they understand and manage the likely impact on current and future business and regulatory compliance.

RP's need to be well placed to comply with this requirement and work on developing multivariate stress testing model is fundamental. *Do we understand at what point our business breaks?*

2.5 Registered providers shall assess their compliance with the Governance and Financial Viability Standard at least once a year. Registered providers' boards shall certify in their annual accounts their compliance with this Governance and Financial Viability Standard.

This will be introduced during 2015/16 and may require internal audit to validate the assessment against the Governance and Viability standard.

Boards will be expected to certify compliance against the Revised Governance & Financial Viability standard on an annual basis.

Consequently it will, perhaps working closely with their audit committees, need to ensure that it receives the right, sufficient and quality of information it needs in order to discharge this certification role.