26th January 2015

Dear Mr Betts

Further to my letter of 25 September and your request for further information on 6 January, this letter provides you with updates on: the Regulator’s capacity; our review into viability regulation, including planned changes in the approach to assessing governance and financial viability of providers; the new Framework and other matters likely to arise over the next 6 months.

As I said in my earlier letter, the changes to our structure and approach to assessing governance and financial viability are part of a wider strategy to help ensure that the Regulator is well-placed to continue to ensure that social housing assets are protected. By protecting the value in these assets, the Regulator protects tenants and taxpayers, and helps maintain lender confidence. Our judgement is that this job is getting more difficult and complex, owing to a range of changes to the market, for example in terms of Government funding and diversification of funding and activities. By maintaining lender confidence the regulator plays a crucial role in supporting new supply, and we are clear that our strategy will make an important contribution to building more affordable homes over the economic cycle.

As part of these changes we intend to revise our Regulatory Framework. Following extensive consultation, I am pleased to say these changes are on track. We expect to publish a revised Regulatory Framework shortly with more detail on our approach to regulation due to be published by the end of March. The revised framework includes an updated Governance and Financial Viability Standard, with additional requirements on risk management and stress testing. This will be supplemented by a Code of Practice to amplify the requirements in the standard.

Operational changes, including to our approach on viability, will dovetail with our revised Framework. Our aim is ensure we have a strategic understanding of both
long-term and short-term risks to the increasingly complex businesses we regulate. To achieve this we will:

- Continue to focus on short and medium-term viability through stability checks for all large providers (those with over 1,000 units). This will include an annual process drawing on providers’ long-term business plans, supported by quarterly updates on short-term issues such as liquidity and covenant compliance. Where this process suggests that our existing published judgement may need to be revised, we will do further work and publish a revised judgement where necessary.
- We will also carry out periodic In-Depth Assessments (IDAs) on all large providers. These will focus on getting to grips with a provider’s risk profile, exposures and the quality of its governance to deal with those risks. Each IDA will be a bespoke piece of work, looking at providers’ viability, stress testing and risk mitigation, and will result in an updated Regulatory Judgement.

The decision was taken to move to this approach as it will enable us more effectively to assess increasingly complex providers and reach a robust judgement on their compliance with the Standard. In particular, the aim of IDAs is to gain more assurance on the long-term health of providers, over an economic cycle, including by examining the new requirements for stress-testing. Regulatory Judgements will usually reflect our findings from the IDA process. To ensure continued compliance in years when providers are not subject to an IDA we will carry out appropriate checks on their finances, as well as reviewing the impact of any significant changes in their business plans and governance structures. This will act as an early warning system, and where we have concerns they will be followed up quickly and effectively.

This new approach chimes with the Cosmopolitan Lessons Learned report, which highlighted the importance of the regulator assessing providers’ long-term resilience when reaching regulatory judgements.

Confidence of stakeholders in the effectiveness of the regulator is essential and initial discussions with them on this revised approach have been positive.

Our revised staffing position will support this operational approach. It will also build on a restructure in 2013 that increased the number of senior staff, and ensured that senior members of staff had direct responsibility for the regulation of every provider.

The latest changes add a further ten posts (net) and in summary involve:

- A considerable strengthening of our intervention function, which deals with non-compliant casework and contingency planning for the most difficult scenarios. The four new posts in this team have been filled, including two new senior financial posts (both filled by experienced qualified accountants)
Additional capacity in our strategy function, to enhance our skills on governance, market analysis and value for money, and private finance. Three senior posts have been created and filled with staff with appropriate professional skills, including someone with a banking background, and a lawyer with considerable experience around corporate governance and structure in Registered Providers.

A further five senior financial analysis staff in our operations team, along with some related and consequential changes to other roles which will lead to a net increase of three posts overall. As things stand, we have filled four of these roles, and the process for securing a fifth senior person, and recruiting other financial analysis staff for vacant roles (which arose due to promotions in the recruitment round just completed), is on-going. Attracting suitable staff with the right finance skills has in the recent past been a challenge, and this experience was borne out in the latest round of recruitment. However, we are confident that most posts will be filled by April, and that we will have a sufficient critical mass of finance staff to perform our role effectively.

The additional roles have been funded within the HCA’s overall budget. This reflects the commitment of the HCA Board and Accounting Officer to support the Regulation Committee in maintaining a strong Regulatory function.

Whilst this recruitment will help to solve the resource constraints we have had a period when we were carrying a number of vacancies in our financial analysis roles. To help manage this, and to ensure delivery of the current year’s programme of financial viability reviews, we have procured some additional external financial expertise to help with the assessments of a number of providers. The services undertaken by these professional services firms is being overseen by senior staff, and is subject to the same quality assurances process we use for other judgements. All judgements produced with the support of professional services firms will therefore be corporately owned by the Regulator in the same way as the judgements produced by permanent staff.

The decision to procure this additional support was taken at the end of July, which is why I did not mention it when I appeared before the Committee earlier that month, and normal government procurement rules were followed. Following an open tender exercise Campbell Tickell and Altair were appointed and started providing professional services in November. Appointing two firms enabled us to ensure conflicts of interest could be effectively managed and this was a key part of the tender process along with ensuring value for money in the services provided. The combined cost of the services is expected to be up to £160,000 with the contract due to complete before the end of this financial year. From April our staff, supplemented by the additional roles mentioned above, will move to regulating the sector under the revised operational approach outlined earlier in this letter.

Further matters arising over the next six months that may be of interest to the Committee include:
• We will continue our regular publication of Regulatory Judgements
• The Global Accounts, which sets out the sector’s financial performance in 2013-14, due to be published in March
• The Quarterly Surveys setting out key financial trends which come out approximately six weeks after every quarter end

In summary, planned changes are part of a long-term strategy to strengthen the regulator so that it remains well-equipped to meet its statutory objectives in a rapidly changing market. I am confident that planned changes will improve our performance, building on the significant improvements to our regulation in the past three years.

Yours sincerely

Julian Ashby
Chair of the HCA Regulation Committee