Better regulation and impact assessment at the UK FSA

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Overview

- Introduction to the FSA
- Our approach to better regulation
- Our approach to impact assessment (IA)
- The role of EFR (our Department)

Introduction to the FSA (1)

- **The Financial Services Authority (FSA) is responsible for authorising and regulating the circa 30,000 firms that make up the UK's financial services industry**
  - Deposit-taking
  - Investment banking
  - Asset management
  - Life and non-life insurance providers/intermediaries
  - Private pension providers/intermediaries
  - Wholesale markets eg the London Stock Exchange
- **We are 100% funded by fees levied from the industry (2009-10 FY budget c£415m)**

Introduction to the FSA (2)

- **We have four statutory objectives:**
  - Market confidence
  - Consumer protection
  - Consumer awareness
  - Financial crime
- **We do not have an explicit competition objective but our Principles of Good Regulation require us to take account of the effects on competition of rule changes**
- **FSMA (2000), which established the FSA, includes explicit requirements relating to Cost Benefit Analysis (Section 155)**
  - Quantification of costs; analysis of benefits
  - CBA must be published as an annex to a consultation paper that seeks stakeholder reaction to proposed rule change(s)

Our approach to better regulation (1)

- **As the previous slide illustrates, the FSA was designed with better regulation principles in mind**
  - Legal requirement to consult on policy changes
  - Legal requirement to include CBA in published consultation documents
  - Legal requirement to explain how proposed rule changes meet our Principles of Good Regulation
- **Accountability requirements also met institutionally**
  - Statutory Consumer and Practitioner Panels
  - FSA decided to set up additional Small Firms Panel

Our approach to better regulation (2)

- **We are a risk-based regulator (so we are Hampton compliant)**
- **And a more principles-based regulator**
- **What about the other elements of better regulation?**
  - Simplification – Handbook review looked at stock of existing rules
  - Administrative burdens – baseline estimated, but no target
  - Impact assessment…………………………

Our approach to IA (1)

- **Problem identification**
  - we use market / regulatory failure analysis
- **Policy objectives**
  - We identify risks to our statutory objectives
- **Option identification, analysis and comparison of impacts**
  - We use both high level and detailed, quantitative cost-benefit analysis
- **Monitoring, ex-post review**
  - An expanding area of work for us
- **Stakeholder involvement**
  - Statutory Panels, also informal and formal consultation throughout the policy making process

Our approach to IA (2)

What do we mean by market failure?

“In the FSA's work, a principle we have enunciated…is that regulatory action should only be taken when there is market failure. Now this is in fact a weak definition of the circumstances of when regulatory action is justified, since all realistic markets – that is all markets which exist in practice – have some elements of market failure...It is an argument too often deployed by those who favour intervention that any market failure justifies intervention. The strong – and to me correct – test goes beyond that: there must be both market failure and the prospect that intervention will provide a net benefit. This involves recognising that regulatory intervention has a cost and…a probability of failure. Identification of a market failure should not lead to the assumption that regulatory failure is less likely, or less costly. It is an open and empirical question, which needs analysis on a case by case basis." [Hence the need for CBA]

Callum McCarthy, Chairman, FSA

Our approach to IA (3)

FSA

What do we mean by regulatory failure?

- Regulatory failure is, like market failure, an economic justification for further regulatory intervention (including deregulation).
- For our purposes, regulatory failure means an intervention whose economic costs were higher or economic benefits lower than was originally expected such that the net effect is harmful (or more harmful than it need have been).
- Regulatory failure is important for the Commission because it may propose measures whose rationale is to remove regulatory or similar barriers to the single market.

Our approach to IA (4)

- **MFA/RFA (to decide whether an intervention can produce net benefits):**
  - What is the relevant economic market or markets?
  - What are the material market failures and/or regulatory failures in the relevant market(s) now?
  - If no intervention or no further intervention takes place, will an improvement in welfare take place? will the market failures be corrected in the short term?

Our approach to IA (5)

- **High level CBA (to decide how to intervene):**
  – What broadly are the regulatory options?
  – What are the economic and other costs and benefits of the options, relative to doing nothing?
  – What is the plan for further CBA work?

Our approach to IA (7)

MFA / CBA in the policy process

INITIAL STAGE

Preliminary policy

Development

High level MFA and CBA

RESEARCH STAGE & WRITE UP STAGE

Full policy development

Full CBA

FURTHER RESEARCH IF NEEDED

Determine final policy

Further CBA if necessary

Implementation

EPC

Policy proposals

MFA

High level CBA

Plan for investigating costs and benefits

Consultation paper

Draft rules

Full CBA

Policy Statement

Final Rules

Revised CBA if necessary

The role of EFR (1)

- Department of 20+ postgraduate qualified microeconomists
- Provide advice to policy makers on whether there is a market failure or regulatory failure-based case for intervention
- Also advise to ensure compliance with CBA requirement in FSMA
- Independent sign off of MFA and HLCBA before policy papers go to decision making body (EPC)
- Independent quality control process improves policy making

The role of EFR (2)

- **One third of our resource is devoted to research**
  - Eg modelling the macroeconomic implications of changing capital requirements; ex-post review of introducing new mortgage sales regime
- **Promoting IA in the EU**
  - Lamfalussy level 3 committees
  - DG Internal Market
  - European Council/Parliament
  - World Bank capacity building programme in south east Europe (Ljubljana, Sofia, Bucharest)