# 3L3 Impact Assessment Guidelines

## Part 1

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# Content of the presentation

1. Pillars of IA and advantages of IA

2. Overview of the 3L3 IA Guidelines.

3. Questions and answers.

# 1.1. The four pillars of an IA

1. **Market/regulatory failure analysis** (MFA/RFA)
2. **Identification and analysis of policy options**
3. **Public consultation**
4. **Post-implementation policy review** (as appropriate)

# 1.2. Advantages of an IA

1. **Better quality** of policy making
2. More **transparent** policy making
3. Better **communication** with regulated firms
4. Enhanced **credibility**
5. Saves time in the long run as **reduced risk of regulatory failure**
6. Compliance with **legal obligations** (not true for all countries)
7. Practice **in line with EU policy** & OECD Guidelines

# 2. IA Guidelines overview

1. The Guidelines document
2. IA in eight steps
3. IA summary tables
4. Key features of IA
5. Working methods
6. IA Reporting

# 2.1. The IA Guidelines document

- The Guidelines may seem long at first, but: core of the document only **~25 pages**;
- Gentle introduction: background information, IA in eight steps (p. 9 and 10), screening IA - full IA (p.14);
- Ready-to-use summary tables (p. 8 and 9);
- The rest of the document: ready-to-use list of questions, Excel tool, references.

# 2.2. IA in eight steps

1. **Identifying the problem**, i.e. the market or regulatory failure, and the threat it poses to one or several regulatory objectives.

2. Stating the **regulatory policy objective** and **linking it to the high-level regulatory objectives**.

3. **Developing several policy options** to achieve the regulatory policy objective.

# 2.2. IA in eight steps

4. **Analysing the positive and negative impacts** of each policy option.

5. **Comparing** options through the **net impact** and identification of the **preferred policy option(s)**.

6. **Consulting on the draft policy proposal, which includes sections reporting on IA or an IA report**.

# 2.2. IA in eight steps

7. **Publishing the responses** received and giving **public feedback**.

8. Once it is implemented and enforced, **keeping the policy under review** as appropriate.

# 2.3. IA Summary Tables

**Problem & the reg./sup. response**

Table 1: MFA/RFA

Table 2: Regulatory/supervisory policy response

**Detailed analysis of the reg./sup. response**

Table 3: Benefits and costs

Table 4: Overall net effect

Table 5: Overall net effect when strong uncertainty

**Consultation & review**

Table 6: Consultation, feedback, review date

| THE PROBLEM | |
|---|---|
| What is the problem?<br>Is the issue identified likely to have an EU-wide impact on market participants/end users and on the smooth functioning of the single market? | |
| What evidence shows that the problem is significant? | |
| Is the problem due to market failure?<br>What is the market failure? | [Information about market failure analysis can be found in section 1.3. of the Guidelines] |
| Is the problem due to regulatory/supervisory failure?<br>What is the regulatory/supervisory failure? | [Information about regulatory failures can be found in section 1.4. of the Guidelines] |
| What regulatory objective is put at risk by the problem? | [Information about regulatory objectives can be found in section 1.5 of the Guidelines] |
| Is it or is it not likely that the problem will be solved over time without a new regulatory policy? Give reasons | |
| Is the case for regulatory/supervisory action justified? | |

| REGULATORY POLICY RESPONSE | |
|---|---|
| Policy option 1 | |
| Specific / Operational objective | [Information about operational objectives can be found in section 1.8. of the Guidelines] |
| How would achieving the objective alleviate/eliminate the problem? | |
| Policy option 2 | |
| Specific / Operational objective | |
| How would achieving the objective alleviate/eliminate the problem? | |
| Policy option 3 | |
| Specific / Operational objective | |
| How would achieving the objective alleviate/eliminate the problem? | |
| Which policy option is the preferred one? Explain briefly. | |

# IMPACT ASSESSMENT OF EACH PROPOSED POLICY

| BENEFITS & COSTS OPTION-1 etc. | QUALITATIVE DESCRIPTION | QUANTITATIVE DESCRIPTION | MONETARY VALUE |
|---|---|---|---|
| Benefits | | | |
| Direct costs | | | |
| Compliance costs | | | |
| Quantity of products offered | | | |
| Quality of products offered | | | |
| Variety of products offered | | | |
| Efficiency of competition | | | |

# IMPACT ASSESSMENT OF PROPOSED POLICIES

| POLICY OPTIONS | SHORT TERM | | | LONG TERM | | | OVERALL NET EFFECT |
|---|---|---|---|---|---|---|---|
| | Positive Effects | Negative Effects | Net Effect | Positive Effects | Negative Effects | Net Effect | |
| Option-1 | | | | | | | |
| Option-2 | | | | | | | |
| Option-3 | | | | | | | |

# IMPACT ASSESSMENT OF EACH PROPOSED POLICY

| OPTION-1 etc. | POLICY EFFECT | LIKELIHOOD | NET BENEFIT |
|---|---|---|---|
| Scenario - 1 | | | |
| Scenario - 2 | | | |
| Scenario – 3 | | | |

# CONSULTATION & REVIEW

| | | |
|---|---|---|
| Consultation period | Start: | End: |
| Participation | (low, medium, high) | |
| Summary of reactions received | | |
| Feedback publication date | | |
| Did the feedback result in a policy change? Explain briefly. | | |
| Proposed review date (when appropriate) | | |

# 2.4. Key features of IA

1. **Proportionality** and **flexibility**

2. **Screening IA** and **Full IA**

3. **When to start** an IA

4. **Qualitative** and/or **quantitative** IA

# 2.4.1. Proportionality & flexibility

- Time constraints
- Resource constraints
- Significant structural and cost implications of policy proposals

⇒ IA should be **proportionate to the problem at hand and the policy chosen**

⇒ **Distinction:** Screening IA and Full IA

# 2.4.2. Screening IA and full IA

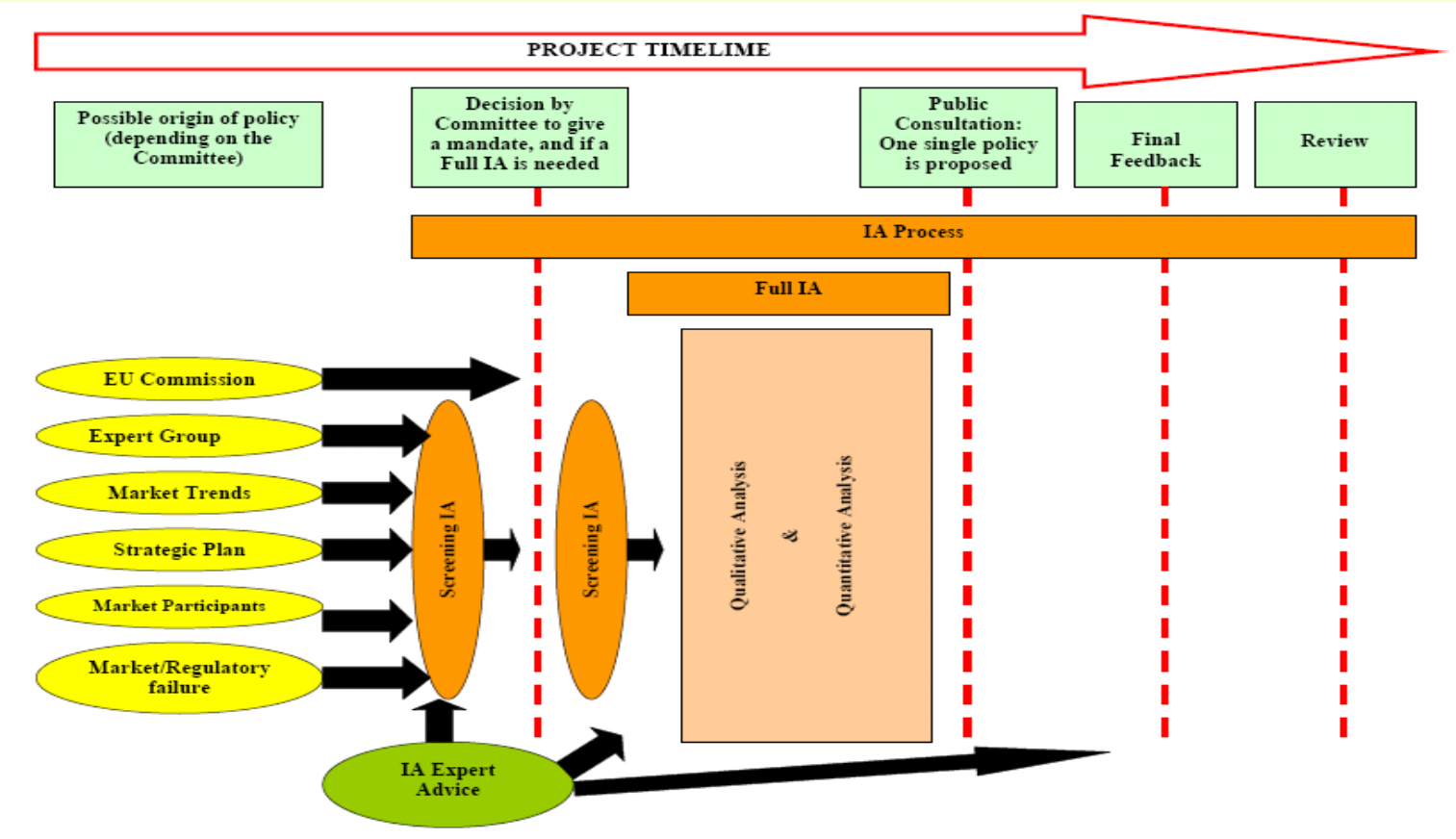
- **Screening IA**
  - Quick IA, i.e. steps 1-5 on a principles basis
  - 2 possible uses: before & after the mandate by an L3 Committee
  - Tool to assess the need for a Full IA => assessment whether a full IA is required or not

- **Full IA**
  - After the mandate when Screening IA not enough
  - May extend the Screening IA modestly or in a substantive way

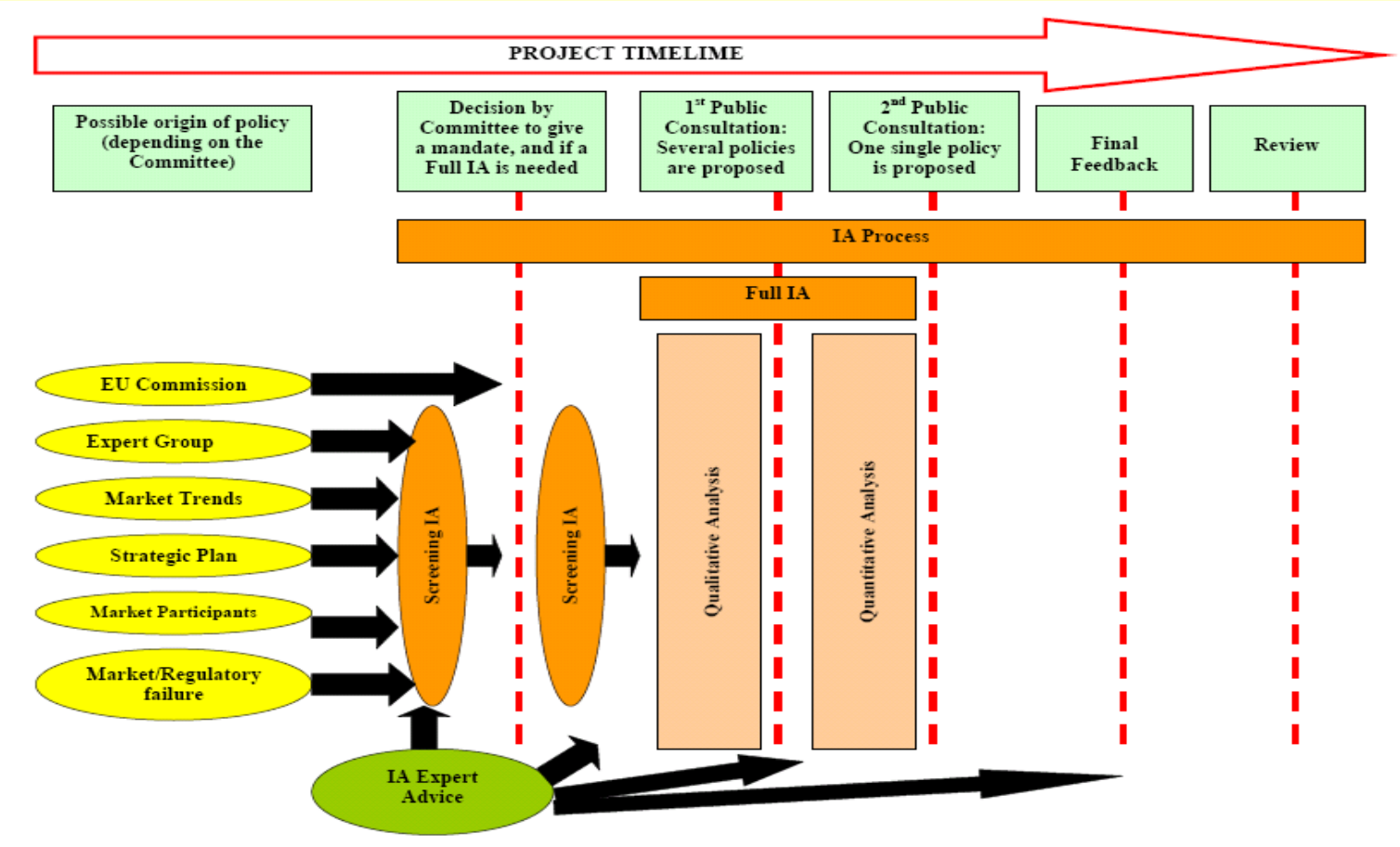
# 2.4.2. Screening IA & Full IA

- IA need not be detailed, costly and time consuming
- **Much of the time a Screening IA is sufficient**
- Sometimes, but rarely, no IA is needed
- **In some cases**, a **Full IA** should be carried out

# 2.4.2. Process 1 - 1 consultation



# 2.4.2. Process 2 – 2 consultations



# 2.4.3. When to start

- Wrong approach: use of IA once the policy decisions have already been made, i.e. at the end of the policy making process

- Correct approach: **using IA** right from the start of the policy making process, **when policy options are still open**

=> IA is a **tool to help with the final policy decision** (and neither a means to justify the decision ex post nor a substitute for decision making)

# 2.4.4. Quantitative and qualitative IA

- **IA is typically qualitative** in nature
- **Sometimes** it is possible and reasonable to **complement the qualitative analysis by a quantitative analysis**
- **Spectrum** of quantitative analysis: quick & dirty to lengthy & costly
- Is a quantitative evaluation of the negative and positive impacts of regulatory / supervisory policies possible? Costs easier to evaluate than benefits. Aim: obtaining a positive net benefit. Often no precise numbers are needed, i.e. enough to over-evaluate the costs and under-evaluate the benefits

# 2.5. Working methods

- The Committee expert group chairmen could ensure that **members of the policy expert group are assigned to conduct the IA**

- One or more Committee's **IA experts should attend the meetings of the expert group** to advice on IA work

- **Advice from the IA experts** also **during a Screening IA**

# 2.6. Reporting on IA

- **Summary** of the work undertaken (**<30 pages**, excluding appendices)
- **States assumptions** or **uncertainties** as well as **knowledge gaps**
- Use **simple** and **non-technical language**
- Puts **technical details** or **supporting documents in appendices**

# 3. Questions & Answers

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# 3L3 Impact Assessment Guidelines

## Part 2

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# Content of the presentation

1. Preparing a Screening or a Full IA

2. What to do for consultation

3. Keeping policies under review

# 1. Preparing an IA

1. What is the problem?
2. Market/regulatory failure analysis
3. Regulatory objectives and policy objectives
4. Developing policy options
5. The L3 Committee perspective
6. Assessing benefits, costs and net benefit
7. Comparing policy options

# 1.1. What is the problem?

- Description of the **problem as it is perceived**.
- Evidence showing that the problem is **significant**.
- Answering the question by asking whether there is a significant **market / regulatory failure**
- If no regulatory intervention, **will the market correct the failure by itself**?
- **Can regulation improve the situation?**

# 1.2. Market / regulatory failure analysis – MFA & RFA

- **Market failure** => inefficiency

- Types of market failures:
  - informational asymmetry
  - externality
  - market power
  - public good

# 1.2. MFA & RFA

- **Regulatory failure** => inefficiency
- **Unforeseen or unintended effects** of policies (e.g. evolving, dynamic market environment or plainly inappropriate regulation or appropriate regulation has a side effect)
- Regulation does **increase the cost of producing financial services**

# 1.2. MFA & RFA

- Both in MFA and RFA identifying all **stakeholders** is important

- Stating whether or not there is an **economic case for intervention.** When no firm conclusion, the screening analysis could recommend further analysis (**Full IA**)

- Whenever possible the analysis should be based on **objective evidence**

# 1.3. Regulatory & policy objectives

- When there is a **market/regulatory failure**, there is a need to show that it poses a risk to at least one **regulatory objective**

- Note: there may be a risk to a regulatory objective without a market or regulatory failure (e.g. resources, not enough staff, quality of staff)

# 1.3. Regulatory & policy objectives

- But what is the link to policy?
  **Three types of policy objectives:**
  - **general** (or final)
  - **specific** (or intermediary)
  - **operational**

- Useful for **bridging the gap** between the general regulatory objectives and the regulatory policy proposal

# 1.4. Developing policy options

- **Considering several options** (e.g. incl. “to-do-nothing” = “status quo”, “market solution”) helps to ensure that the best policy is chosen

- “Strawmen”, i.e. **unrealistic options, are not helpful when considering alternative policies**

- **“To-do-nothing”** is not necessarily the same as the **“market solution”** (= no regulation at all)

Aim: giving **insight into the difficulties of policy choice**

# 1.5. L3 Committee perspective

- Consider the aggregate effect (no need to develop an IA for each EU member state)

  => **main focus on the single market**

- But: IA conclusions should be mindful to the fact that:
  - markets often are **local**
  - **countries may differ** with respect to impact
  - **negative effects in some jurisdictions may be offset by positive effects in others**

# 1.6. Assessing benefits, costs and net benefit

- Assessing whether there is an **economic case for intervention**

- Need to bear in mind **3 cases**:
  - regulation fails to address the problem,
  - **regulation helps, but cost > benefit,**
  - **regulation helps and cost < benefit.**

  => IA helps to decide which of these cases applies

# 1.6. Assessing benefits / costs / net benefit

- Key aspect: evaluate **incremental costs and benefits**, i.e. change of costs and change of benefits which are triggered by the policy (in excess of business-as-usual)
- Important to **define the baseline** against which policy impacts will be judged
- **Compare alternative policies**
- Compare best policy to the status quo **in terms of net benefit**

# 1.6. Assessing benefits / costs / net benefit

- A quantitative evaluation of cost, benefits and net benefit is not always possible. => A **qualitative analysis** will often be enough (e.g. Screening IA)
- Even when a quantitative assessment is possible, assessing the net benefit may be difficult (case of a quantitative, but non monetary assessment)
- A precise evaluation of cost, benefits and net benefit is not always needed
  Policy aim: obtaining a positive net benefit

# 1.6.1. Assessing costs

- **Implementation costs**:
  - regulator's costs
  - compliance costs (typically costs incurred by regulated firms to comply with policy)
  - indirect costs (change in quantity, quality or variety offered, change in efficiency of competition)
- Direct costs are in fact borne by firms and, in the long run, firms will pass on costs to their clients (investors)

=> Ultimately, **investors will bear all the costs** (though this may not be true in the short run)

# 1.6.1. Assessing costs

- Example of indirect cost: **inefficiency of competition**
  - Benefits of competition:

    decreases prices, increases the quality of products, those who perform better will win,

    entrepreneurial spirit can unfold/innovation
  - How to assess the **right degree of competition?**

    Is competition = **rivalry**, i.e. a process where firms try to outperform each other?
    No, this would not give any hint about how much rivalry is good!

    => **Effective competition** (= no excess profit)

# 1.6.1. Assessing costs

- **Fixed vs. variable costs**:
    - Fixed costs: do not vary with output. In the long run, all costs can be considered variable
    - Variable (or operating) costs vary with output
- **Set-up (or one-off) costs vs on-going costs**

# 1.6.2. Assessing benefits

- It is often easier to assess costs than benefits – particularly when the monetary value is to be evaluated

- But the evaluation of benefits often is less difficult than it might seem at first glance
  - **Being precise about MFA/RFA** makes it easier to assess the benefits
  - **Techniques** that help: comparison to a historical standard, evaluation by a proxy (e.g. closely related variable, simulation) or by "opportunity benefits", use of break-even approach, survey

# 1.6.3. Discounting

- **Neglecting discounting** leads to **anomalies**

  - Example 1: not discounting the very small yearly benefit of a policy with a huge set-up cost leads to an infinite net benefit

  - Example 2: not discounting for a policy which is also available in the future, means always deferring the policy (because investment with a positive return at time t1 will generate more money for the same policy at time t2)

# 1.6.4. Risk and uncertainty

- The IA should **take risk and uncertainty explicitly into account**

  - **Simulations**

    Sensitivity analysis = considering a range of possible values for a key parameter

    Can also be used for several key parameters

  - **Boundary analysis**

    Placing lower / upper bounds on parameters

# 1.7. Comparing policy options

- Ideally, alternative policy options should be compared by an analysis of their **positive and negative effects**, including the **net effect**

- In quantitative and qualitative terms?

  But, fortunately, this is not always needed:
  If the expected benefit outweighs costs and is broadly the same for several policies, these policies can be compared by **considering costs only**

# 2. Consultation

- All L3 Committees already practice consultation
- Practice both of **ex ante and ex post consultation** (whereby ex ante and ex post refer to the publication of the consultation paper)
- Need to **identify and engage with key stake-holders as early as possible**, and give them recognition for their contributions

# 2. Consultation

- **Feedback statement**
  - Publication of responses or of summary of responses
  - Explanations for why decisions are made (no changes as well as changes to the draft policy paper) and of how the policy will be taken forward

# 3. Keeping policies under review

- Keeping policies under review ensures that policy makers know whether policy and regulatory objectives have been achieved, and can take action when not
- Review particularly important when likely **impact of a policy is uncertain but potentially significant**
- Need to **have a good baseline** (e.g. compliance costs) against which to make ex post assessments
- **Ex post IA** (same methodology as ex ante IA; caveat: difficulty to demonstrate causalities)

# 4. Questions & Answers

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