



HM TREASURY

# Financial Services Bill:

## Impact Assessment

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**November** 2009





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ISBN 978-1-84532-652-4  
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# 1

## Introduction and summary impact assessment

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**1.1** This “final proposal” stage impact assessment sets out the case for Government intervention through the proposals that are included in the Financial Services Bill. This case is presented in terms of an analysis of the benefits, costs and likely impact of the proposed reforms.

**1.2** The assessment follows on from the “consultation stage” impact assessment published alongside the consultation document *Reforming financial markets*, in July 2008. The analysis has been updated to reflect changes of policy, and to incorporate additional evidence where available.

**1.3** The Government received over 100 responses to *Reforming financial markets*. Responses were received from representative bodies, including the British Bankers’ Association (BBA), the Building Societies Association (BSA), the London Investment Banking Association (LIBA) and the Investment Managers Association (IMA), as well as a number of individual banks. There was also considerable input from consumer bodies and law firms. The Government also received responses from many other organisations, ranging, for example, from Age Concern to the Financial Ombudsman’s Service. Those responses which were not provided on a confidential basis have been published on the Treasury’s website.

**1.4** This impact assessment is being published simultaneously with the Parliamentary introduction of the Financial Services Bill, and only covers those reform proposals included in the Bill.

**1.5** A number of elements of the wider reform package set out in *Reforming financial markets* do not require primary legislation and will instead be implemented through FSA rules. These will be consulted on in the usual way, as required by FSMA, and consultation will include a detailed cost-benefit analysis. Therefore, these reforms are not analysed in this document.

**1.6** An impact analysis for each proposal is provided in the body of this document, set out in the order in which the proposals appear in the Financial Services Bill. The numeric totals in the summary impact analysis reflect the sum of the benefits and costs for each policy. In line with impact assessment guidance, the summary analysis only contains benefits and costs associated with the Financial Services Bill.

## Summary: Intervention & Options

Department /Agency:  
**HM Treasury**

Title:  
**Impact Assessment of the Financial Services Bill**

**Stage:** Final proposal stage

**Version:** Bill/01

**Date:** 19 November 2009

**Related Publications:**

**Available to view or download at:**

<http://www.hm-treasury.gov.uk>

**Contact for enquiries:** [banking.reform@hmtreasury.gsi.gov.uk](mailto:banking.reform@hmtreasury.gsi.gov.uk)

**Telephone:**

**What is the problem under consideration? Why is government intervention necessary?**

The government intervenes in financial markets to maintain financial stability and ensure they operate efficiently and fairly. Intervention helps address a number of market failures including asymmetries of information between buyers and sellers, high barriers to entry, and externalities which arise when the social costs of failure of financial institutions exceed private costs. Recent disruption has highlighted serious failures in the global financial regulatory system. In particular, deficiencies have emerged in governance and risk management in the institutional investment chain, quantity and quality of capital and liquidity of assets, and in regulation's ability to minimise systemic risk. Longer-term interventions are now needed to ensure a similar disruption cannot occur in future.

**What are the policy objectives and the intended effects?**

The policy objectives of the Financial Services Bill are to:

- Strengthen financial regulation to ensure it is fit for purpose and capable of adapting to innovative and evolving markets, including improving prudential regulation and supervision;
- Place greater emphasis on monitoring and managing system-wide risks – including by legislating to create a Council for Financial Stability
- Improve corporate governance and remuneration practices; and
- Empower consumers and boost confidence in financial markets.

**What policy options have been considered? Please justify any preferred option.**

A number of policy options have been explored to address the objectives above, including the option to do nothing. The following impact assessments set out the options that have been explored, likely costs and benefits, the preferred option selected, and the evidence base to support this proposal.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?**

The effectiveness of the legislation will be subject to ongoing review.

**Ministerial Sign-off** For final proposal Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options*

Signed by the responsible Minister:



..... Date: 19 November 2009

## Sum of costs and benefits

The time period used for present value calculations is 10 years unless otherwise specified.

Policy proposal	Total cost (PV)	Total benefit (PV)	Net benefit (NPV best estimate)
Establishment of an autonomous consumer education authority and rollout of money guidance (Time period = 52 years)	£1,706-1,710m	£13,362-17,684m	£13,816m
Remuneration transparency requirements	N/A	N/A	N/A
Remuneration control	N/A	N/A	N/A
Recovery and resolution plans	N/A	N/A	N/A
Establishing stand-alone powers for FSA to take emergency action to restrict short-selling and request disclosures of short-selling	£61m	£912-9,176m	£4,132m
Strengthening regulators' enforcement powers	£8.6m	£31m	£22.4m
Collective redress mechanisms	£451.9m	£1,549.4m	£1,097.5m
Banning unsolicited credit card cheques	£112-1,048m	£112-917m	£0 to -65m
Allowing the cost of funding the exercise of SRR powers to be recovered from the FSCS	N/A	N/A	N/A
Expanding the role of the FSCS to act as an agent to facilitate payment to UK customers if foreign banks default	£0	£0.95m	£0.95m
Extension of FSA Information Gathering Powers	N/A	N/A	N/A
Giving HMT powers to request information directly from participants in the Asset Protection Scheme	£0	£0	£0
Extending Director of Savings remit to undertake on work on behalf of MOJ (Accountant General)	£61.5m	£93.3m	£31.8m



# 2

## Individual Impact Assessments

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## Summary: Intervention & Options

Department /Agency:  
**HMT**

Title:  
**Impact Assessment of national rollout of Money Guidance and consumer financial education body**

Stage: Final proposal

Version: 2

Date: 19 November 2009

**Related Publications:** Reforming Financial Markets paper and IA; the Government's long-term approach on financial capability; Thoresen Review; Financial Capability action plan

**Available to view or download at:**

<http://www.hm-treasury.gov.uk>

**Contact for enquiries:** Anna Deibel-Jung

**Telephone:** 020 7270 6426

**What is the problem under consideration? Why is government intervention necessary?**

Levels of financial capability among the UK population are low and over-indebtedness is a major problem. Around 19m people in the UK are especially vulnerable to the consequences of poor financial decision making but are least likely to seek independent financial advice.

**What are the policy objectives and the intended effects?**

Financial capability programmes aim to give people the knowledge, skills, confidence and motivation to make sound financial decisions and engage responsibly with financial services. By helping people manage their finances better and plan for the future, financial capability interventions can help them to avoid the distress of financial difficulty and improve their financial and overall wellbeing.

**What policy options have been considered? Please justify any preferred option.**

Candidates to lead the financial capability agenda include the FSA (as now), the OFT and a new independent consumer financial education body (CFEB). CFEB adds profile and overcomes operational barriers.

The Thoresen Review reviewed options for Money Guidance and recommended a 'partnership model' (central coordination and delivery via partners). Preliminary evaluation of the pathfinder has demonstrated that this model can be effective. This IA presents three versions of this model: the preferred option focuses on the policy aim of reaching those who could benefit most from the service.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?**

Following interim evaluation in October 09, full evaluation of the Money Guidance pathfinder will be completed in 2010. CFEB will be subject to independent value for money review.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description: independent consumer financial education body and Money Guidance (delivered through a partnership model and targeted at those most vulnerable to the consequences of poor financial</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' Consumers: time costs of using Money Guidance - £342m Industry and Government: cost of Money Guidance - £944m Government: funding of specialist advice agencies - £5-9m Industry: cost of National Strategy for Financial Capability - £415m				
	<table border="1" style="width: 100%;"> <tr> <td style="width: 60%;"><b>One-off</b> (Transition)</td> <td style="width: 40%; text-align: center;"><b>Yrs</b></td> </tr> <tr> <td style="background-color: #ffffcc;">£ 165m</td> <td style="text-align: center;">5</td> </tr> </table>		<b>One-off</b> (Transition)	<b>Yrs</b>	£ 165m	5
	<b>One-off</b> (Transition)		<b>Yrs</b>			
	£ 165m		5			
<table border="1" style="width: 100%;"> <tr> <td style="width: 60%;"><b>Average Annual Cost</b> (excluding one-off)</td> <td></td> </tr> <tr> <td style="background-color: #ffffcc;">£ 79m</td> <td></td> </tr> </table>	<b>Average Annual Cost</b> (excluding one-off)		£ 79m			
<b>Average Annual Cost</b> (excluding one-off)						
£ 79m						
<b>Total Cost (PV)</b>		<b>£ 1,706-1,710m</b>				
Other <b>key non-monetised costs</b> by 'main affected groups' Financial Services Industry: costs of increased shopping around by consumers						

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' Consumers: use of service including increased access to benefits - £9,978-10,863m Industry: less bad debt, reduced cost to serve etc - £2,313-3,860m Government: less pension credit, increased VAT - £1,098-2,789m UK economy: reduced absenteeism – Up to £172m				
	<table border="1" style="width: 100%;"> <tr> <td style="width: 60%;"><b>One-off</b></td> <td style="width: 40%; text-align: center;"><b>Yrs</b></td> </tr> <tr> <td style="background-color: #ffffcc;">£ n/a</td> <td></td> </tr> </table>		<b>One-off</b>	<b>Yrs</b>	£ n/a	
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	£ n/a					
<table border="1" style="width: 100%;"> <tr> <td style="width: 60%;"><b>Average Annual Benefit</b> (excluding one-off)</td> <td></td> </tr> <tr> <td style="background-color: #ffffcc;">£ 644m</td> <td></td> </tr> </table>	<b>Average Annual Benefit</b> (excluding one-off)		£ 644m			
<b>Average Annual Benefit</b> (excluding one-off)						
£ 644m						
<b>Total Benefit (PV)</b>		<b>£ 13,389-17,684m</b>				
Other <b>key non-monetised benefits</b> by 'main affected groups' Better informed and more financially capable consumers (benefits for consumers, industry, Government and wider society and economy); Government and industry: long-term reduction in funding for debt advice.						

**Key Assumptions/Sensitivities/Risks**  
 Assumes continuation of current National Strategy programmes.  
 Cost and benefit modelling based on revised assumptions, informed by Money Guidance pathfinder.

Price Base Year 2008	Time Period Years 52	<b>Net Benefit Range (NPV)</b> <b>£ 11,679-15,978m</b>	<b>NET BENEFIT (NPV Best estimate)</b> <b>£ 13,828m</b>
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	Spring 2010				
Which organisation(s) will enforce the policy?	FSA (and OFT)				
What is the total annual cost of enforcement for these organisations?	£0				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	N/A				
What is the value of the proposed offsetting measure per year?	£ N/A				
What is the value of changes in greenhouse gas emissions?	£ N/A				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table border="1" style="width: 100%; text-align: center;"> <tr> <td style="width: 25%;">Micro 150- 400</td> <td style="width: 25%;">Small 3000-7000</td> <td style="width: 25%;">Medium 8000-16000</td> <td style="width: 25%;">Large 0.5-1.2m</td> </tr> </table>	Micro 150- 400	Small 3000-7000	Medium 8000-16000	Large 0.5-1.2m
Micro 150- 400	Small 3000-7000	Medium 8000-16000	Large 0.5-1.2m		
Are any of these organisations exempt?	<table border="1" style="width: 100%; text-align: center;"> <tr> <td style="width: 25%;">No</td> <td style="width: 25%;">No</td> <td style="width: 25%;">N/A</td> <td style="width: 25%;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of	£ 0	<b>Net Impact</b>
Decrease of	£ 0	<b>£ 0</b>

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

This impact assessment updates the impact assessments published alongside the 'Reforming financial markets' paper in July 2009 on Money Guidance and a new consumer education body. It:

- expands on the rationale for a new consumer financial education body and provides more detailed cost forecasts; and
- provides an overview of the interim evaluation findings from the Money Guidance pathfinder and refreshes the cost and benefit modelling undertaken as part of the Thoresen Review. This analysis has been informed by evidence, trends and learning from the pathfinder.

### **Consumer financial education body (CFEB)**

#### Background

In the Reforming Financial Markets paper, the Government proposed to introduce legislation requiring the Financial Services Authority (FSA) to set up a new consumer education authority to take the lead on financial capability across the UK.

Provisions in the Financial Services Bill remove from the FSA its objective of promoting public understanding of the financial system and transfer this to CFEB, expanding this to encompass a wider and more detailed definition of financial education/capability. The FSA's financial capability programmes, delivered as part of the National Strategy for Financial Capability, transfers to CFEB along with this objective. CFEB will additionally lead the national implementation of Money Guidance from 2010. Money Guidance will represent the majority of the body's activity and expenditure (certainly in the short to medium term) and this IA will examine the costs and benefits of Money Guidance in some detail.

#### Rationale for intervention

This proposal was driven by a need to ensure that rollout of Money Guidance was appropriately and sustainably delivered, funded and governed and a policy desire to increase the relative prioritisation and profile of the financial capability agenda, while building on the excellent progress made by the FSA to raise levels of financial capability across the UK.

#### Policy options

The previous impact assessment published alongside Reforming financial markets considered three policy options for leading financial capability programmes and Money Guidance.

##### *Through the FSA*

The FSA has a regulatory objective to promote public understanding of the financial system and leads the National Strategy for Financial Capability. It is also well placed to take on national implementation of Money Guidance as it has experience of working in partnership with other organisations and owns existing consumer information and guidance products under the MoneyMadedeclear brand.

This option however has a number of practical problems:

- Money Guidance represents a major additional delivery requirement for the FSA;
- Money Guidance budgets would not be ring-fenced within the FSA;
- FSA would have to manage the non-levy funding streams separately which would incur additional costs both for the FSA and for other funding organisations; and
- the FSA cannot delegate its functions to any other organisation which could cause difficulties in outsourcing delivery to partners.

Some of these points could be addressed through changes to primary legislation but could thereby fundamentally impair the FSA's independence.

##### *Through the Office of Fair Trading (OFT)*

The OFT has a statutory objective around consumer education. However, the strategic fit is less strong: the remit is more general and the approach of the OFT to date, including the focus of its consumer-facing services such as Consumer Direct, is more remedial, aimed at helping people assert their consumer rights and seek redress, than being educational and preventative. It would not be straightforward for the OFT to take over and build on the FSA's extensive suite of consumer education

projects and products, and it would lack the experience of delivering financial capability programmes, in particular the Money Guidance pathfinder.

*Through a new consumer financial education body (CFEB) – preferred option*

This option was set out for consultation in the Reforming Financial Markets paper and is described in detail above. This option is preferred as it brings greatest profile for the financial capability agenda, allows a relatively seamless transfer of the National Strategy and will address the barriers noted under consideration of the FSA option above, such as flexibility to receive a range of funding sources e.g. revenue from a levy on consumer credit firms, Government funding and a funding stream from dormant accounts.

## **Money Guidance**

### **Background**

The Government committed to addressing the ‘advice gap’ (see below for further details) in 2007 in its long-term approach on financial capability and commissioned an independent review, led by Otto Thoresen, CEO of AEGON UK, to investigate the feasibility of a national generic financial advice service. An interim report including a consultation was published in October 2007; the Review reported in March 2008.

The review set out a blueprint for a national ‘Money Guidance’ service and recommended a large-scale pilot or pathfinder to test this blueprint ahead of national rollout. The Government accepted the recommendation and announced plans for a £12m pathfinder, jointly funded and led with the Financial Services Authority (FSA).

The pathfinder launched in April 2009 in the North West and North East of England and will run until March 2010. The Government announced in Reforming Financial Markets that the service would be rolled out nationally from spring 2010, subject to interim findings from the evaluation of the pathfinder demonstrating that the service can be a success.

This impact assessment is based on the original impact assessments published alongside the ‘Reforming financial markets’ paper. It has been updated to reflect evidence, trends and learning from interim evaluation findings from the pathfinder, which after 6 months is already proving the service can be effective. It covers how the service will be rolled out, how it will function and the costs and benefits of the service.

### **Rationale for Government intervention**

#### *Prevention is better than cure*

The Thoresen Review analysis found that 19.2m people in the UK are vulnerable to the consequences of poor financial decision-making (those between 6-11 points on the scale below), with 7.5m of those being especially vulnerable. Proactive, preventative help and support for those vulnerable to the consequences of poor financial decisions could help these people avoid the distress of financial difficulty, feel more confident and motivated in engaging with the financial services industry and prepare better for their own and their families’ future.

## The Money Guidance needs of the UK population – a summary

	Most Vulnerable 9–11 points	Regular Users 6-8 points	Infrequent users 2–5 points	Occasional Users 0-1 points
No. of UK adults	7.5 million	11.7 million	20.7 million	5.6 million
Vulnerability	Multiple drivers of vulnerability: lack of access to commercial advisers, poor planning ahead, very limited savings or protection, limited financial portfolio and therefore limited knowledge of products, difficulty making ends meet and over-indebtedness (almost half). Many who are working have no pension. One in five may have literacy problems and 50% live in areas with high levels of multiple deprivation.	Vulnerability driven primarily by not being adviser prospects (majority), not being experienced at choosing products, some lack of savings, over-indebtedness (one in three). Showing signs of not being good at planning ahead and more than one in three with low scores on making ends meet. However, generally good at keeping track of money and many have some savings. One in ten may have literacy problems and >20% live in areas with high levels of multiple deprivation.	Vulnerability driven primarily by not being adviser prospects (about two-thirds), not being experienced at choosing products or not keeping track of their money. Results in some over-indebtedness (around one third) and some lack of savings but generally good at planning ahead and staying informed. At upper end of scores, some struggling to make ends meet. A small number have literacy problems and one in ten live in areas with high levels of multiple deprivation.	Some lack of access to commercial advice and poor at keeping track of money but otherwise no significant signs of vulnerability. Consequences of subsequent poor financial decision-making unlikely to be significant for many (due to relatively high level of saving). Not at risk due to poor financial capability. No strong evidence of poor decision making.

Source: Thoresen Review (March 2008)

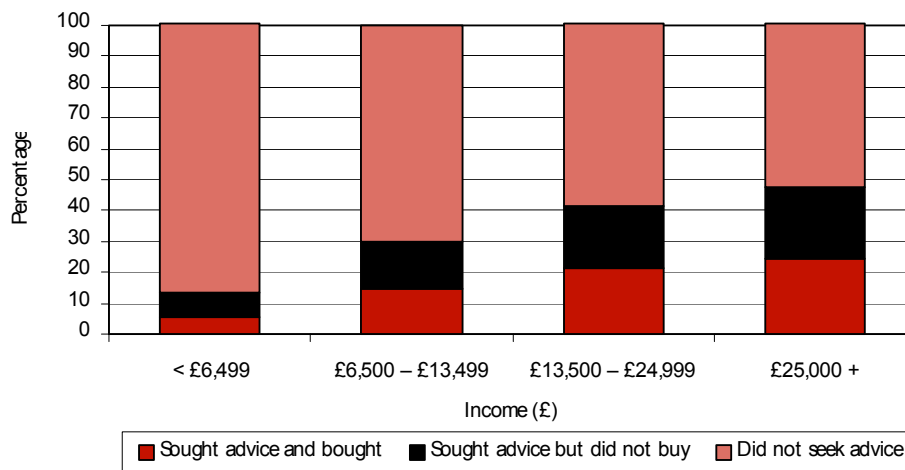
The Government has channelled significant resources into crisis advice services to help people with unmanageable debt problems. Friends Provident Foundation analysis estimates that £160-165m a year is directed to debt advice; Government provides the bulk of this funding with the financial services industry providing around 3%. Demand for debt advice, given the ongoing impact of the global economic downturn on individuals and families, has increased: the Money Advice Trust has highlighted a 100% increase in demand for debt advice with 4 million people expected to seek debt advice this year. Money Guidance could help to redress the balance in the long run, helping consumers avoid the distress of debt problems and reduce the need for high-cost crisis debt advice services.

In this IA, the term ‘most vulnerable’ refers to the 9-11 points cluster in the table above; ‘moderately vulnerable’ refers to the ‘Regular Users 6-8 points’ cluster.

### *Market failure – the ‘advice gap’*

There is currently a gap in the availability and take-up of impartial, affordable, high-quality financial advice, particularly among those on low to median incomes. The Government’s long-term approach on financial capability demonstrated that people on lower incomes are less likely to seek financial advice (see below). Less than 50% of all clients of independent financial advisers (IFAs) are on incomes of below £30,000 although this group represents 87% of the population (based on HMT analysis of the 2006 Labour Force Survey).

## The relationship between income and distribution of advice



Source: Financial Services Consumer Panel annual survey of consumers, 2000 cited in *Financial Capability: the Government's long term approach (January 2007)*

This is supported by research conducted during the pathfinder in the North East and the North West of England. The indicators show that, particularly for vulnerable people, there is a strong reliance on friends and family, internet searches and banks as their first point of call for some types of financial information.

## Sources of information and guidance used by people with differing levels of potential vulnerability to the consequences of poor financial decision making

	Potential level of vulnerability with regard to financial decision making (%)			All (%)
	Most	Moderately	Not	
Friends and family	34	30	23	27
Google search	32	24	22	25
Citizens advice bureau	13	9	4	7
Bank/building society	13	32	38	31
Confused.com	9	10	7	8
Directgov	5	6	8	7
moneysupermarket.com	4	12	13	11
moneysavingexpert.com	2	3	9	6

Source: Continental tracker surveys April – July 2009 (base: all those who had sought information or guidance on financial matters in the previous 12 months; percentages may add up to more than 100% as people may have consulted more than one source)

There is currently no obvious single impartial, trusted and authoritative source of information on personal finance. This is clearly indicated by the fact that the two most frequently cited sources of information, particularly by those who are most vulnerable to the consequences of poor financial decision making, are friends and family and an internet search engine.

This also indicates that Money Guidance would not replace existing financial information sources (including independent financial advisors), but is meeting a gap in the market. It is also providing a more holistic service where people can gain information on all types of money issues.

### *Raising levels of financial capability*

The Government and the FSA have a shared vision of better skilled, better educated citizens who are equipped and motivated to make appropriate financial decisions with confidence. The Money Guidance service will provide the information but also give people the skills and confidence to manage their money effectively. Increased levels of financial capability should result in consumers making better use of their income, benefiting them as well as the economy as a whole.

### **Costs – Money Guidance**

#### Policy options

In the interim report published by the Thoresen Review of generic financial advice in October 2007, the following different business models for the service were proposed.

#### *A 'monolithic' model*

A single national body would deliver all aspects of the service under a single identity. This body would feature a large central organisation and would need to establish a significant footprint throughout the UK. This option is very high cost, including significant infrastructure and staff costs. This option is not preferred as it would introduce an entirely new service where there are existing providers that could already deliver the service.

#### *A 'decentralised' model*

This model would rely on other organisations to provide services directly to consumers. A small central function might run an accreditation scheme as well as lead on public awareness and information activity. Although this option would have low additional infrastructure costs, it is not clear whether this could provide enough strategic direction and coherence to the service to act as a strong call to action for consumers. It could result in an uneven provision of Money Guidance missing out some areas and social groups.

#### *A 'partnership' model - preferred*

The Review recommended a hybrid of these, a 'partnership' model: a central body that has strategic responsibility for the service including service content as well as some centrally-led delivery (such as the website and marketing) with the bulk of delivery provided by existing organisations. This option is a hybrid of the two models described above, combining the advantages of strategic control sitting with the central body and the advantages of using existing organisations with the capacity and expertise to deliver the service 'on the ground'.

#### The pathfinder - background

A £12m large-scale pilot or 'pathfinder', jointly funded and led by the Government and the FSA, was announced in March 2008 to test and further refine the partnership model.

The North West and North East of England regions are chosen on the basis that:

- together the regions' population were demographically representative of the UK;
- around 50% of the population were vulnerable to the consequences of poor financial decision making
- there was potential to establish effective partnerships, in particular with third sector organisations.

The pathfinder launched in April 2009, delivered via three channels, the Moneymadeclear website, a telephone service and face-to-face services delivered by a range of partners. While the Moneymadeclear website and phone line were in practice available across the UK and could also be used by people across the UK who were previously aware of Moneymadeclear or who came across the website, promotional activity only took place in the North West and North East regions. The face-to-face service were available through a network of local partners and local branches of national organisations in the pathfinder regions and only promoted in these regions.

## Operational evidence from the pathfinder

### *Filling the advice gap*

Interim evaluation findings from the pathfinder clearly demonstrate that the service is filling the 'advice gap' by meeting a distinct set of needs that are not fully met by existing providers. This is particularly apparent for certain topic areas that seem to be poorly served by other information providers (budgeting, credit and borrowing and pensions and retirement planning). It is being used as a point of contact for an array of different issues relating to money (from maternity benefits to funeral expenses), suggesting that a single point of contact for money issues is something that people have started to use as soon as it became available.

### *Take up*

Based on current available data the pathfinder is projected to reach the lower end of the 500,000 – 750,000 users target recommended by the Thoresen Review. This figure is based the number of people using the phone and face-to-face service and the number of substantive online sessions (rather than just 'hits') on which the original definition of reach was based, consistent with other organisations' measures. In addition, we have used a new methodology to extrapolate the number of unique Money Guidance users from data on web sessions (227,610 unique web users forecast to March 2010).

In the pathfinder, the three channels have different profiles of usage by vulnerable and non-vulnerable users. The face-to-face channels has been very successful in attracting vulnerable users with around 77% of sessions being with people vulnerable to the consequences of poor financial decision making. Just over half of telephone users are classed as vulnerable, while the web has the lowest proportion of vulnerable users at around 47% in the pathfinder region.

The pathfinder has shown that it can reach those who are potentially vulnerable to the consequences of poor financial decision-making, particularly through the face-to-face and telephone channels. Overall, 50% of the people reached by pathfinder were considered vulnerable to the consequences of financial decision-making which is representative of the pathfinder regions' demographic.

Web usage is high, the number of face-to-face sessions is slightly higher than expected although take up of the phone channel has been low. There is little sign of channel migration by users (e.g. web users transferring to phone or face-to-face to web). Despite the low levels of phone usage, the findings from the pathfinder have shown that the phone channel is being used for different purposes to the web and face-to-face and is reasonably effective in reaching vulnerable people; it is therefore an important component of a national Money Guidance service.

## Lessons for national rollout

There are some important lessons from the pathfinder for the design of the delivery model for national implementation. There are useful lessons on how to strengthen operational management during national implementation, particularly around procurement and contract management.

However, there are also potential changes which could be built into planning for national rollout including:

- testing a more integrated channel approach and building in agreements and incentives for partners and intermediaries to direct people to more cost-effective channels; and
- testing a more diversified approach to marketing e.g. incentivising delivery partners to carry out more local engagement and promotion activity and increasing emphasis on developing relationships with a wide range of organisations to act as referrals partners and intermediaries.

The pathfinder used a variety of different marketing channels with the aim of raising awareness of the *MoneyMadeClear* brand and to drive contacts to the website and phone line. The pathfinder also aimed to test different media channels' effectiveness. Learning so far in the pathfinder is reflected in the approaches considered below although it is too early to draw definitive conclusions on the efficacy of marketing approaches.

## Take-up target for national rollout

The current predicted number of users of pathfinder can be sense-checked against the data from the tracker survey conducted monthly for the pathfinder, which indicates that 3% of the population would be likely to have a need for information and also be likely to contact MoneyMadeClear for information and

guidance. This is comparable with other national information services such as Citizens Advice and DirectGov.

In light of this new evidence, a realistic annual take-up target for national roll out (at steady state) should equate to around 3% of the adult population (roughly 1.5m). The models below cover a range of between just under 3% and just over 4%. We believe however that this figure should be taken as a short/medium term goal and will increase as understanding of the benefits of the service and awareness of the brand builds and overall web usage increases.

#### National rollout: approaches to the partnership model

The pathfinder has shown that the Thoresen partnership model can be effective; therefore, the models proposed here do not fundamentally change the partnership business structure but instead highlight where modifications to the partnership model could be made, based on evidence from the pathfinder.

The two main areas of expenditure are marketing and delivery of face-to-face sessions. Changes to these two areas have an impact on the reach of the service as well as on cost.

Three different approaches to the partnership model delivered through three channels (web, phone and face-to-face) are set out below which each focus on achieving different outcomes. For comparison, costs cited are at year 5 of rollout. In the costs summary above, we have made a conservative estimate that costs will remain constant at year 5 levels. In practice, we would expect costs to decrease over time as the service becomes established.

It is important to note that the options below represent a high-level 'direction of travel' for national rollout rather than final detail. Planning for national rollout will vary as there is more emerging evidence and learning from the pathfinder.

#### **Approach 1 – aims to reach those most vulnerable to the consequences of poor financial decision making**

This option sets out to adjust the pathfinder model so that the service is better targeted at vulnerable people who could most benefit from the service.

##### *Marketing*

This model could place greater emphasis on a 'bottom up' approach to marketing, by incentivising local service delivery partners and intermediaries to refer users to all three channels of the service. The 'on the ground' knowledge of partners and intermediaries and their access to those most vulnerable to poor financial decision makes them well placed to direct more vulnerable people to the service.

Less emphasis could be placed on central marketing, treating this as complementary to local engagement activity.

Although the pathfinder has successfully tested partner-driven engagement and established effective relationships with referral partners and intermediaries, there is some risk attached to refocusing the marketing approach to this extent.

##### *Web*

As the web channel reaches many more people than both telephone and face-to-face, a relatively small percentage change in the vulnerability ratio of web users will have a large impact on the total numbers of vulnerable users.

In this model, marketing of the website and the website itself could be modified to appeal more to vulnerable users. For example, partners and intermediaries could be encouraged to direct vulnerable people to the MoneyMadedclear website, there could be direct links to the MoneyMadedclear website (or content from the website) could be placed on the websites of a wide range of organisations whose client base tends to be more vulnerable to the consequences of poor financial decisions.

While the proportion of vulnerable people using the website will increase, there may be a small reduction in overall usage of the website as a result of reduced mass marketing of the service.

##### *Face-to-face*

The face-to-face service is successfully reaching more vulnerable users in the pathfinder. In this model, the volume of face-to-face sessions would increase and therefore the numbers of vulnerable users would

also increase. Partners could be incentivised to actively seek new clients for money guidance who are vulnerable.

#### *Phone*

The model does not assume any changes to the phone service with take-up and vulnerability mix continuing as forecast for the pathfinder.

### **Approach 2 – aims to maximise take-up**

This option aims to reach a high number of users on a comparable budget. However this option prioritises maximising take-up overall over reaching those vulnerable to the consequences of poor financial decision making.

#### *Marketing*

Centrally driven marketing might focus on promotion of the website, as this is by far the easiest and cheapest way of reaching large numbers of people. Very little might therefore be spent on local engagement work with partners and trusted intermediaries.

#### *Web*

By focusing on marketing of the website, high numbers of web users can be expected. The web focused marketing campaign is more likely to attract a higher proportion of non-vulnerable people, as vulnerable users are harder to target through mainstream advertising and web users are more likely not to be vulnerable. Therefore a higher proportion of new users to the website is likely to reduce the percentage of vulnerable users of the web.

#### *Face-to-face*

Face-to-face sessions would be promoted locally, as for the pathfinder, so that we expect face-to-face sessions to continue with a similar proportion of vulnerable and non-vulnerable users.

#### *Phone*

As the numbers of phone appointments generated through marketing in the pathfinder so far have been low, a switch to marketing the web channel could be expected to lead to only a small decrease in phone sessions. However, a proportion of web users may use the phone channel after seeing the phone number on the website, bringing usage to a similar level as projected pathfinder usage.

### **Approach 3 – aims to reduce overall cost by reducing marketing**

This option broadly follows the pathfinder approach but with minimum marketing and ways to move users to cheaper channels to achieve a lower overall cost. This approach does not specifically target vulnerable people.

#### *Marketing*

Marketing spend might be reduced to a much lower level which is spent on cost effective ways to drive users to the website (the cheapest channel) e.g. search engine key word search.

#### *Web*

This option assumes fewer web users than the other two options as less is spent on marketing to drive users to the web. The vulnerability ratio will remain broadly similar to that in the pathfinder.

#### *Face-to-face*

Face-to-face partners could additionally have the ability to offer to call users for a phone session as an alternative to a face-to-face session to make better use of capacity in instances where queries could be easily dealt with by phone or where there are practical difficulties in holding a face-to-face session.

#### *Phone*

There would be an increase in overall demand for the phone channel as a result of incentivising face-to-face delivery partners to encourage users to take up the phone channel as well as face-to-face sessions. The vulnerability ratio might therefore increase as a result of shifting face-to-face users that have a higher proportion of vulnerable users to the phone.

### Comparison of the three approaches to the partnership model

		Approach 1	Approach 2	Approach 3
<b>No. of users</b>	Face-to-face	263,000	220,000	229,000
	Phone	72,000	60,000	72,000
	Web users	1,316,000	1,791,000	963,000
	(Web sessions)	2,900,000	4,254,000	2,256,000
	Overall users	1,651,000	2,071,000	1,265,000
	(Overall sessions)	3,236,000	4,533,000	2,557,000
<b>% of vulnerable users</b>	Face-to-face	80.0%	71.6%	71.6%
	Phone	58.0%	44.1%	52.3%
	Web	51.1%	38.3%	40.7%
	Overall	56.0%	42.0%	47.0%
<b>No. of vulnerable users</b>	Face-to-face	211,000	157,000	164,000
	Phone	42,000	26,000	38,000
	Web	672,000	685,000	505,000
	Overall	925,000	869,000	595,000
<b>Total costs</b>	Face-to-face	£ 26 m	£ 18 m	£ 17 m
	Phone	£ 3 m	£ 3 m	£ 3 m
	Web	£ 10 m	£ 15 m	£ 7 m
	Overall	£ 39.5 m	£ 36 m	£ 27 m

Source: HMT/FSA working assumptions informed by unpublished KPMG Operational Review Interim Report, dated 20 October 2009

### Breakdown of costs by workstream across three approaches to the partnership model

	Approach1	Approach 2	Approach 3
<b><u>Changing costs</u></b>			
<b>Engagement</b>	£ 6.7 m	£ 10.9 m	£ 2.7 m
<b>Local Engagement/Trusted Intermediaries</b>	£ 4.7 m	£ 1.1 m	£ 0.7 m
<b>Face-to-face</b>	£ 19.4 m	£ 15.9 m	£ 15.1 m
<b>Telephone</b>	£ 2.7 m	£ 2.4 m	£ 2.8 m
<b><u>Static costs</u></b>			
<b>Training and Development</b>	£ 0.7 m	£ 0.7 m	£ 0.7 m
<b>Digital ex MI &amp; AB</b>	£ 2.2 m	£ 2.2 m	£ 2.2 m
<b>Management Information and Appointment Booking</b>	£ 0.4 m	£ 0.4 m	£ 0.4 m
<b>Evaluation</b>	£ 1.5 m	£ 1.5 m	£ 1.5 m
<b>Operation &amp; Strategy</b>	£ 1.2 m	£ 1.3 m	£ 1.3 m
<b><u>Overall costs</u></b>	<b>£ 39.5 m</b>	<b>£ 36.4 m</b>	<b>£ 27.3 m</b>

Source: HMT/FSA working assumptions informed by unpublished KPMG Operational Review Interim Report, dated 20 October 2009

## Preferred approach

The preferred option is Approach 1, which is driven by the central policy objective of targeting those most vulnerable to the consequences of poor financial decision making and who could therefore benefit most from the service. In this model, marketing would be largely devolved to a local level but central control over strategic direction and resources is maintained. This is not without risk but has shown signs of success in the pathfinder which could be built on further. The benefits cited above and presented in more detail later in this IA are entirely based on usage of the service by people especially vulnerable to the consequences of poor financial decision making.

Approaches 2 and 3 proposed a change to the main policy driver of reaching those most vulnerable to the consequences of poor financial decision making. Approach 2 is not preferred, since although it reaches the largest number of people, this is achieved mainly through the website which has the lowest reach among vulnerable people. This approach skews the service towards the web. Approach 3 presents a low cost option but results in lower reach overall, especially among those most vulnerable to poor financial decision making and is therefore not preferred. It carries a risk that take-up of the service will be very low due to little expenditure on marketing.

Elements of the other two models could also be integrated into approach 1. For example, there are some riskier features of approach 3, particularly around improving efficiency in the delivery of face-to-face services and channel shift, that could be incorporated at a later stage into approach 1.

## Phased rollout for the service

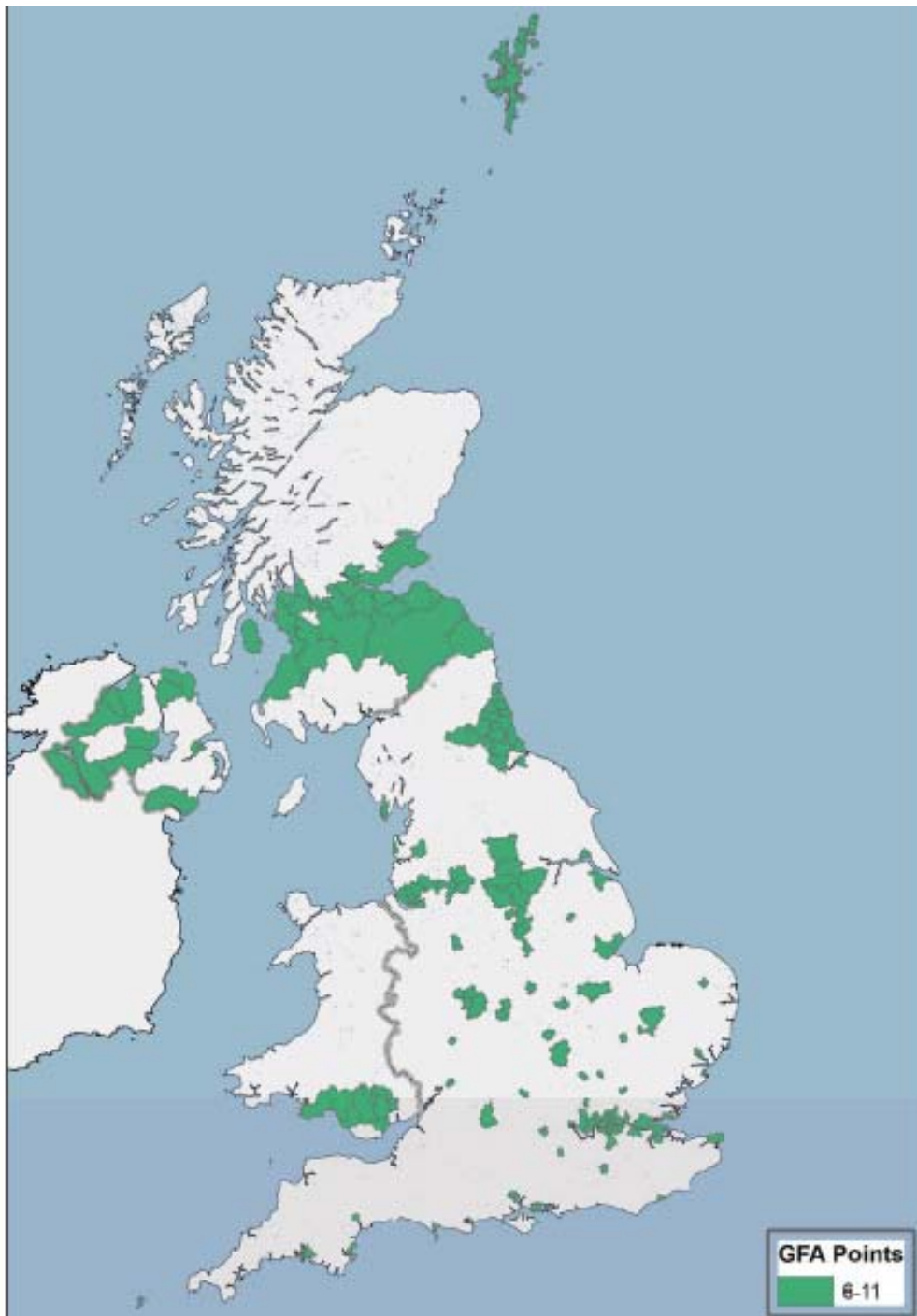
In line with best practice, national rollout of Money Guidance will be phased from spring 2010, building on the pathfinder which in effect becomes the first phase of rollout. This phased approach allows the project team to continue to learn lessons and refine the approach throughout the rollout process.

Both the phone and web channels are already available nationally but capacity on the phone will ramp up as required. National marketing will also be implemented in phases, starting in spring 2010.

Face-to-face sessions will continue to be available in the pathfinder regions from spring 2010. Face-to-face services will be phased in across the rest of the UK thereafter.

At this stage of planning, the preferred strategy for rollout of face-to-face services is to target 'priority areas', i.e. areas where there is a high proportion of people particularly vulnerable to the consequences of poor financial decision making. This will help to ensure that those who could benefit most from face-to-face money guidance are served first. The map below shows these areas.

**Map of the areas with the greatest concentration of those most vulnerable to the consequences of poor financial decision making**



Source: Experian Report from Thoresen Review Annex 7 - Potential Demand and Infrastructure Mapping with Customer Insight Portraits (2008)

## Rollout options

The four options set out below balance the aim to roll out the service quickly nationally to enable more people to benefit from Money Guidance with the desire to continue to learn lessons during rollout before achieving full national coverage. The options range from an incremental phased approach over five years to a faster 'ramp up' in the first two to three years, before reaching steady state in year 5.

<b>Option 1</b>		<b>Forecast Pathfinder in Region (to end March 2010)</b>					
			<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
<b>No. of Users</b>	Face-to-face	28 k	40 k	71 k	91 k	192 k	263 k
	Phone	4 k	18 k	22 k	36 k	60 k	72 k
	Web	207 k	640 k	742 k	912 k	1,167 k	1,316 k
	Overall	239 k	698 k	835 k	1,039 k	1,418 k	1,651 k
<b>% of Vulnerable users*</b>	Face-to-face	77.8%	78.6%	84.3%	84.6%	80.0%	80.0%
	Phone	51.2%	45.2%	48.4%	51.6%	54.8%	58.0%
	Web	47.1%	40.7%	43.5%	46.1%	48.6%	51.1%
	Overall	50.7%	43.0%	47.1%	49.7%	53.1%	56.0%
<b>No. of Vulnerable Users</b>	Face-to-face	21 k	31 k	60 k	77 k	153 k	211 k
	Phone	2 k	8 k	11 k	19 k	33 k	42 k
	Web	98 k	261 k	322 k	420 k	567 k	672 k
	Overall	121 k	300 k	393 k	516 k	754 k	925 k
<b>Total costs</b>	Face-to-face		£ 4 m	£ 7 m	£ 9 m	£ 17 m	£ 26 m
	Phone		£ 1 m	£ 1 m	£ 2 m	£ 3 m	£ 3 m
	Web		£ 7 m	£ 7 m	£ 10 m	£ 9 m	£ 10 m
	Overall		£ 13 m	£ 15 m	£ 20 m	£ 28 m	£ 39.5 m

<b>Option 2</b>		<b>Forecast for Pathfinder (to end March 2010)</b>					
			<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
<b>No. of Users</b>	Face-to-face	28 k	50 k	88 k	113 k	192 k	263 k
	Phone	4 k	23 k	32 k	59 k	60 k	72 k
	Web	207 k	747 k	906 k	991 k	1,167 k	1,316 k
	Overall	239 k	820 k	1,026 k	1,163 k	1,418 k	1,651 k
<b>% of Vulnerable users</b>	Face-to-face	77.8%	82.2%	84.6%	84.3%	80.0%	80.0%
	Phone	51.2%	45.2%	48.4%	51.6%	54.8%	58.0%
	Web	47.1%	40.7%	43.5%	46.1%	48.6%	51.1%
	Overall	50.7%	43.4%	47.1%	50.1%	53.1%	56.0%
<b>No. of Vulnerable Users</b>	Face-to-face	21 k	41 k	75 k	96 k	153 k	211 k
	Phone	2 k	10 k	15 k	30 k	33 k	42 k
	Web	98 k	304 k	394 k	457 k	567 k	672 k
	Overall	121 k	356 k	484 k	583 k	754 k	925 k
<b>Total costs</b>	Face-to-face		£ 8 m	£ 11 m	£ 13 m	£ 20 m	£ 26 m
	Phone		£ 1 m	£ 2 m	£ 3 m	£ 3 m	£ 3 m
	Web		£ 9 m	£ 7 m	£ 9 m	£ 9 m	£ 10 m
	Overall		£ 18 m	£ 20 m	£ 25 m	£ 32 m	£ 39.5 m

<b>Option 3</b>		<b>Forecast Pathfinder in Region (to end March 2010)</b>					
			<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
<b>No. of Users</b>	Face-to-face	28 k	67 k	104 k	191 k	252 k	263 k
	Phone	4 k	22 k	33 k	48 k	60 k	72 k
	Web	207 k	854 k	948 k	1,030 k	1,167 k	1,316 k
	Overall	239 k	943 k	1,085 k	1,269 k	1,479 k	1,651 k
<b>% of Vulnerable users*</b>	Face-to-face	77.8%	84.8%	84.3%	80.1%	80.0%	80.0%
	Phone	51.2%	44.1%	47.6%	51.1%	54.5%	58.0%
	Web	47.1%	40.7%	43.5%	46.1%	48.6%	51.1%
	Overall	50.7%	44.0%	47.5%	51.4%	54.2%	56.0%
<b>No. of Vulnerable Users</b>	Face-to-face	21 k	57 k	88 k	153 k	202 k	211 k
	Phone	2 k	10 k	16 k	25 k	33 k	42 k
	Web	98 k	348 k	412 k	475 k	567 k	672 k
	Overall	121 k	415 k	515 k	652 k	802 k	925 k
<b>Total costs</b>	Face-to-face		£ 11 m	£ 14 m	£ 21 m	£ 25 m	£ 26 m
	Phone		£ 1 m	£ 2 m	£ 2 m	£ 3 m	£ 3 m
	Web		£ 10 m	£ 10 m	£ 10 m	£ 10 m	£ 10 m
	Overall		£ 23 m	£ 25 m	£ 33 m	£ 38 m	£ 39.5 m

<b>Option 4</b>		<b>Forecast Pathfinder in Region (to end March 2010)</b>					
			<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>Year 4</b>	<b>Year 5</b>
<b>No. of Users</b>	Face-to-face	28 k	95 k	124 k	201 k	252 k	263 k
	Phone	4 k	29 k	40 k	52 k	67 k	72 k
	Web	207 k	1,139 k	1,120 k	1,167 k	1,225 k	1,316 k
	Overall	239 k	1,263 k	1,284 k	1,420 k	1,545 k	1,651 k
<b>% of Vulnerable users*</b>	Face-to-face	77.8%	84.8%	83.5%	80.0%	80.0%	80.0%
	Phone	51.2%	44.1%	47.6%	51.1%	54.5%	58.0%
	Web	47.1%	40.7%	43.5%	46.1%	48.6%	51.1%
	Overall	50.7%	44.0%	47.5%	51.4%	54.2%	56.0%
<b>No. of Vulnerable Users</b>	Face-to-face	21 k	81 k	104 k	161 k	202 k	211 k
	Phone	2 k	13 k	19 k	27 k	37 k	42 k
	Web	98 k	464 k	487 k	538 k	595 k	672 k
	Overall	121 k	556 k	6109 k	730 k	837 k	925 k
<b>Total costs</b>	Face-to-face		£ 15 m	£ 17 m	£ 22 m	£ 25 m	£ 26 m
	Phone		£ 2 m	£ 2 m	£ 2 m	£ 3 m	£ 3 m
	Web		£ 11 m	£ 10 m	£ 10 m	£ 10 m	£ 10 m
	Overall		£ 28 m	£ 30 m	£ 35 m	£ 38 m	£ 39 m

Source: HMT/FSA working assumptions informed by unpublished KPMG Operational Review Interim Report, dated 20 October 2009

**Notes:**

In each of the above options Year 1 is assumed to be financial year 2010-11. £3m of the funding from year 1 will be spent in 2009-10 on preparatory work in anticipation of a launch in spring 2010.

The percentage of vulnerable users in phone and web will decrease in the first few years of national roll out. This is because the North East and the North West (pathfinder regions) have a higher vulnerable demographic compared to the rest of the country; therefore there may be a decrease on extending the service across the UK.

## Costs - CFEB (excluding Money Guidance)

It is expected that implementation of the national Money Guidance service will form the largest part of the expenditure of the new body. We have also assumed a continuation of current levels of investment in programmes delivered as part of the National Strategy for Financial Capability, which excluding Money Guidance costs, currently cost around £16m a year.

In addition, there will be corporate costs of setting up CFEB, including staff appointments and recruitment, and the year-on-year running costs of CFEB as an organisation, although most operational costs, including staff costs, have been absorbed in the costs for delivering Money Guidance and other financial capability programmes. It is also anticipated that CFEB will be able to share FSA corporate services, which will allow CFEB to benefit from economies of scale.

### Overall costs of CFEB

	Year 1		Year 2		Year 3		Year 4		Year 5
	Set up cost	Running cost	Set up cost	Running cost	Set up cost	Running cost	Set up cost	Running cost	Steady state costs
Corporate costs	£2m	£1m	-	£1m	-	£1m	-	£1m	£1m
National Strategy projects	-	£16m	-	£16m	-	£16m	-	£16m	£16m
Money Guidance (option 2)	£4m	£14m	£1.1m	£18.8m	£0.4m	£24.7m	£0.1m	£32.3m	£39.5m
<b>Total</b>	<b>£6m</b>	<b>£31m</b>	<b>£1.1m</b>	<b>£35.8m</b>	<b>£0.4m</b>	<b>£41.7m</b>	<b>£0.1m</b>	<b>£49.3m</b>	<b>£56m</b>
	<b>£37m</b>		<b>£37m</b>		<b>£42m</b>		<b>£49m</b>		

Source: HMT/FSA working assumptions. Costs derived from costs section above

### Optimism bias

When considering optimism bias for the Money Guidance service we have broken down costs into confidence levels. Those costs we have high confidence in at 5% optimism bias, medium confidence at 10% optimism bias and low confidence at 20% optimism bias. With optimism bias in steady state the cost of the preferred model is £42.3m (costs without optimism bias are £39.5m) giving an overall annual optimism bias of 7%. Based on version 1 the total cost of running the Money Guidance service over 52 years is £944m, with optimism bias it comes to £1,015m.

If we apply a 7% optimism bias to all costs of the CFEB, including running costs, additional projects and Money Guidance, it increases the costs to £1779.9-1783.9m compared to costs without optimism bias £1705.5-1709.5m in NPV terms.

### Benefits

Financial capability programmes aim to give people the knowledge, skills, confidence and motivation to make sound financial decisions and engage responsibly with financial services. By helping people manage their finances better and plan for the future, financial capability interventions can help them to avoid the distress of financial difficulty and improve their financial and overall wellbeing.

The FSA's National Strategy for Financial Capability has already reached 8 million people with the aim of improving levels of financial capability across the UK. It is on track to reach 10 million people by 2011.

The FSA has recently published research showing that financial capability also has benefits on people's psychological wellbeing. Higher financial incapability is associated with higher mental stress, lower reported life satisfaction, and health problems associated with anxiety or depression. This has obvious benefits for individuals and their relatives, but also for the economy as a whole (via reduced

absenteeism), and the Government. (For further details see FSA Occasional Paper on 'Financial Capability and Wellbeing' in Annex).

The original impact assessment and the Thoresen Review set out the potentially significant benefits of a national Money Guidance service to the consumer, financial services industry (FSI), Government (UKG) and the economy as a whole. The original benefits model developed for the Thoresen Review by Deloitte helps tell the story about the benefits, particularly in terms of monetising benefits, but should be considered alongside the early, largely qualitative evidence from the pathfinder and the limitations of the model.

### *Changes to the model*

The model works as a lifetime benefits model: it projects individuals through life events and produces a profit and loss account and a balance sheet for each individual based on their decisions for each year projected. The model itself works over 52 years, as some benefits of financial capability will only be realised in later years of life. The model is built around those who are vulnerable to the consequences of poor financial decision making (or at least a proxy for this group), so there may be benefits from Money Guidance for non-vulnerable users that are not captured in the model.

The Deloitte model (originally used for the Thoresen Review) has been updated to reflect the early evaluation findings from the pathfinder.

The largest change to the model has been the reduction in the number estimated at using the service per year. The original model used estimates from Thoresen, which, as discussed in the earlier section, have been scaled down to a more realistic number, representing a reach of around 3-4% of the population each year. This change in the model has led to large decreases in both costs and benefits.

The model has also been reworked to be more reflective of the age profile of users of pathfinder. This is a balance between the characteristics of the general population and the profile of current users of pathfinder (the age breakdown of pathfinder users was not solely used because of concerns about the demographic of early adopters may not be representative and potential changes over time). This has the effect of decreasing the benefits to consumers, as there are fewer young people in the sample, thereby decreasing benefits achievable over their lifetime. It also has the effect of increasing the demand for products and increased pension saving, because there are higher percentages in the middle age range and a decrease in the elderly.

The model was originally designed to use a rough proxy of low and medium earners for those vulnerable to the consequences of financial decision making, as there is a slight positive correlation between the two. This has now been broadened out to reflect more closely the more vulnerable groups by lowering the income threshold and including those whose income comes solely from benefits. The effect of this is increasing the benefits to consumers, financial services industry and government as lower income users are seen to benefit more (because they are currently assumed to hold fewer products, including pensions, than higher income consumers).

Informed by evidence from the pathfinder, some new benefits have been included to rebalance the model from a focus on benefits accruing from purchasing financial products and from budgeting. While a large proportion of users of Money Guidance are using the service to inform product choice and/or to help with budgeting, there is evidence from the pathfinder that the benefits are much more varied. The model has been revised particularly to reflect this new evidence about the large number of enquiries concerning social security and tax credits. This considers the fact that some people will then take up benefits that they may not have previously known they were entitled to. The model has taken into account the fact that some people may not be entitled to claim or may already be claiming all they were entitled to.

Equally some new costs have been taken into account. A large number of users were referred to other organisations, so the figures from pathfinder of referrals to other agencies have also been taken into account in Government funding. The model has also been checked and potential benefits reviewed and reduced to avoid any double counting of benefits of other government programmes or government-funded sources of specialist help and advice.

The model was originally based on the assumption that over the course of their lifetime around 10% of the vulnerable population act on the recommendations the service gives them and act on it fully and efficiently. This could also represent a higher percentage of consumers acting less efficiently on guidance given. At the time data from the prototypes in Thoresen suggested this was an underestimate of the true figure. This has also been suggested by early data coming out of pathfinder, even just a week after receiving guidance, indicating that the Thoresen figure was a major underestimate. Equally from the

qualitative data the majority of users of Money Guidance say that it has a significant influence on their decision-making, suggesting that, even where other sources of information or advice were also used, Money Guidance is a pivotal factor and a key driver of benefit. The reworked model has increased the number taking action, although, when this is matched with the drop to a more realistic prediction of usage of Money Guidance, the percentage overall actually decreases. The percentage taking action has also been retained to a conservative level to ensure that there is no double counting of benefits and to allow for optimism bias.

The reworked Deloitte model has updated forecasts of the costs and benefits of the Money Guidance service – these are summarised below. The figures are expressed in net present value terms at 2008 prices over 52 years.

#### *Benefits beyond the model*

The model focuses only on benefits to the individual, as much of the data used is held on an individual level. It is clear that for many individuals an increase in their financial capability will also have additional benefits for their household, including on dependants.

The model also only considers the benefits to those vulnerable to the consequences of financial decision making. The target audience for Money Guidance is 19.2 million vulnerable people, however there are also large number of non-vulnerable people who are also benefiting from Money Guidance. It is important to note that Money Guidance is actually helping far more people than are reflected in the benefits model.

There are also additional benefits to the wider economy of consumers having an increased income and spending power; these wider benefits have not been modelled.

If these factors are taken into account the benefits of Money Guidance are likely to be much higher.

#### *Limitations of the model*

It is impossible to model all of the variables in the benefits of Money Guidance over the next 50 years, so the model should be read in context with the qualitative insights, considerations of how the world may change over the next 50 years (such as internet usage) and the potential for need of the service to increase or decrease depending on the wider context.

The model is also tied to those vulnerable to the consequences of poor financial decision making, however the model is build around income rather than the characteristics of the baseline survey so may not dovetail exactly. This means there may be more benefits or costs that are not built into this model. The benefits stated in this section should be considered in this context.

**Summary of the impact of Money Guidance on consumers, the financial services industry (FSI) and the UK Government (UKG)**

£ million (2008 prices)	Updated Costs	Updated Benefits
<b>Consumers</b>		
Use of Money Guidance service	£342m	£9,113m
Increased access to benefits		£665m - £1,750m
<b>Indicative total (excl. impact of shopping around)</b>	<b>£342m</b>	<b>£9,778m - £10,863</b>
<b>FSI</b>		
Funding 50% of Money Guidance	£472m	
Customers shopping around	Not quantified	Not quantified
Bad debt reduction		Up to £1,076m
Acquisition costs (advising and selling)		£589m to £1,178m
Reputation		£11m to £22m
Reduced cost of regulation		Up to £106m
Increase in demand for products (excl. general insurance)		£531m to £1,478m
<b>Indicative total (excl. impact of shopping around)</b>	<b>£472m</b>	<b>£2,313m to £3,860m</b>
<b>UKG</b>		
Funding costs of Money Guidance	£472m	
Impact on funding of agencies	£5m to £9m	Not quantified - costs may fall if Money Guidance successful
Pension credit savings		Up to £1,027m
Increased VAT receipts		£877m
Tax receipts from savings products		£221m to £885m
Other tax/benefit impacts <sup>1</sup>	Not quantified	Not quantified
Increased access to benefits	Impact taken into account under committed UKG expenditure	
<b>Indicative total (excl. impact on other tax/benefits)</b>	<b>£477m - £481m</b>	<b>£1,098m to £2,789m</b>
<b>UK economy</b>		
Reduced absenteeism		£172m

Source: unpublished Deloitte analysis 2009. Cost data derived from costs section above.

*Benefits to consumers*

The Deloitte model assumed a number of 'sample' actions consumers might take as a result of using the service to calculate benefit to consumers. The pathfinder is verifying the assumptions made in the model on benefits in these areas. The commentary below explains the breakdown of what is contributing to these quantified benefits.

One of the key areas where pathfinder seems to be providing benefits is in **budgeting** to avoid becoming overdrawn and to better manage consumption and savings. The model assumes that people facing a shortfall in income reduce expenditure and draw down savings (if available) rather than financing it through expensive debt. Many contacted Money Guidance about budgeting, sometimes in relation to managing debt. Better budgeting prevents people getting into unmanageable debt in the first place or can help them control debt to prevent them becoming unmanageable. It also free up spare income for spending or saving. An illustrative example of how Money Guidance is helping people with budgeting is below.

<sup>1</sup> Other taxes/benefits include Housing Benefit, Council Tax Benefit, tax rebates on pension contributions, changes in tax on personal income and changes in Corporation Tax.

*Martin kept going overdrawn and incurring bank charges, not because he did not have enough money in his account, but because of the timing of direct debits. He went to MoneyMadedclear to try and improve his budgeting.*

*Source: Personal Finance Research Centre (unpublished interim report)*

**A more rational management of debt:** the model assumes that in the case of a surplus people will pay off high interest rates first and reallocate short term savings to debt reduction. In the pathfinder some people were using it as a pre-crisis debt help service, for people who were already in debt and were worried that their repayments were becoming unmanageable. This clearly supports the policy objective of Money Guidance as a preventative service and will also have benefits for both the industry and Government. An example of this aspect of the service is below.

*Julie thought she needed a debt consolidation loan, Money Guidance talked her through the interest rates she was paying on her credit commitments and suggested that she started paying off the highest rates first. Julie decided to follow this course of action rather than consolidation.*  
*Source: Personal Finance Research Centre (unpublished interim report)*

People were also using the service for non-crisis debt enquiries such as mortgage shortfalls. This frees up highly-trained specialised debt advisors, who are currently unable to cope with the levels of people seeking debt advice, for more problematic or complex cases. The model has not quantified the benefit of freeing up time of specialist advisors.

**Getting the best rates on financial products:** in the model this is measured as shopping around, seen as higher returns on short-term savings products, a lower interest on debt products and a higher annual payment in pension products compared to the 'no guidance' situation.

A large number of people particularly on the website were looking for information on financial products, including some products where available impartial information is sparse. Many of these people have then gone on to purchase products based to some extent on pathfinder information. For some products (especially mortgages) this was disproportionately sought by those who are vulnerable to the consequences of poor financial decision making, clearly showing that pathfinder adds to these individuals' financial capability to choose the right products. For example:

*Gerry was looking for the best deal on fixed rate mortgages and used the MoneyMadedclear website comparison tables to choose what he felt was the best rate for him.*  
*Source: Personal Finance Research Centre (unpublished interim report)*

**Purchasing basic financial products:** while there is limited data currently, it seems a number of people were enquiring about basic bank accounts, this suggests some users are using money guidance to discuss purchasing financial products for the first time. This has benefits for the consumer in terms of more appropriate products for their needs (i.e. appropriate insurance), however it also supports the financial inclusion agenda by helping to reduce the number of people without a bank account.

**Long term planning:** people acting on guidance are assumed to not opt-out of auto enrolment pension schemes offered to them. A number of people have been asking in pathfinder about retirement and pension planning. Long term planning in this area and ensuring the best annuity rates will have obvious future benefits for both consumers and government as levels of income will remain more constant over the years and pension credit contributions from Government will decrease. Users were considering what their projected pension entitlement might be, suggesting how money guidance can add to financial capability in this area. Currently in this area people are mainly using IFAs or friends and family to talk about pensions, showing that for those who are unable to afford the services of an IFA (see table on page 13), Money Guidance is providing a service that was previously lacking.

A large number of people using Money Guidance were asking about **eligibility for financial assistance and support**. Increasing take up of benefits and tax credits has well documented benefits. It improves people's income in both the short and longer term, which has been added into the model. Increasing take up of social security has well established other benefits for the Government and wider society; a reduction in pressure on other services; and can lead to poverty reduction and an improvement in social inclusion. These additional benefits have not been modelled, due to the lack of precise data.

The service can also benefit consumers by helping them to avoid the stress and anxiety caused by financial problems; this in turn leads to a reduction in absenteeism, which benefits the whole economy.

From the face-to-face and telephone data there are also indications that users of Money Guidance are receiving a **holistic service**, and are given broader information and guidance than the initial query indicated. This is particularly apparent in the face-to-face channel. It means once options are talked through with a Money Guide new areas for discussion/investigation open up. For example in face-to-face only 6% sought information on savings and investment while 16% of users actually received information. This shows how Money Guidance could be a service that joins together different parts of an individual's financial life to provide a more comprehensive service. Money Guidance is also referring onto the relevant bodies, particularly for pensions and benefits. This indicates that people did not originally know to go to these organisations and Money Guidance is providing a useful sign posting and joining up function as well.

### Reason for contacting Moneymadeclear compared with subjects on which information and guidance was given

	Face-to-face		Telephone	
	Sought (%)	Received (%)	Sought (%)	Received (%)
Budgeting	23	37	12	15
Credit & borrowing	13	19	16	18
Mortgages	5	9	19	19
Pensions & retirement planning	9	16	13	14
Protection	3	11	8	10
Savings and investment	6	16	14	17
Social security and tax credits	24	38	7	11
Tax	4	8	0	1

Source: Pathfinder management information, March to August 2009

Note percentages may total more than 100 per cent as information may have been sought and/or given on more than one topic

### Benefits to financial services industry

For the financial services industry (FSI), more informed and capable consumers should result in the following benefits.

- **Reduction in the cost of default.** Poor levels of customer understanding of financial products and associated risk leads to some extent both to defaults on credit products and an inefficient absence of persistency on some savings products. The findings already suggest that, as a result of using Money Guidance, a significant number of people are taking steps to become less likely to default by budgeting and managing their current income. However as consumers get a better understanding of the different financial products they purchase and the risks involved, there should be increasingly lower levels of default;
- **Reduced 'cost to serve'** - including reduced marketing and distribution costs as more capable consumers will not need so much help accessing and choosing financial products and are better able to know what financial products could benefit them. Money Guidance users are taking advantage of the service to make decisions about product purchase. It seems clear that Money Guidance is helping people make an informed choice about financial products, particularly via the comparison tables, and that this will have benefits for industry in terms of a reduction in marketing and distribution costs.
- **Increased propensity to purchase financial products** – A number of people have used the service to seek help in purchasing financial products, including basic bank accounts, suggesting that Money Guidance is already capturing people who do not currently own financial products. A large proportion of enquiries were also about more complex products (such as mortgages) from people who were vulnerable, suggesting that Money Guidance can also help increase propensity to purchase more complex financial products. Money Guidance seems to be creating more confident and capable consumers that are more likely to engage with the industry and take out a wider range of products.

- **Reputational benefits** – better informed consumers who are better able to understand financial products and have sound expectations of product performance should result in increased levels of trust, as consumers are more comfortable with their provider and less expenditure on marketing is required to promote trust and confidence. The pathfinder interim evaluation has found examples of people deciding to stick with their current provider because they realise they have the best deal.
- Linked to reputational benefits is less time spent dealing with **complaints**. A number of people using Money Guidance were enquiring about problems they had encountered with financial products. By signposting people directly to the appropriate place to deal with complaints Money Guidance could reduce the time spent on a complaint by industry and preserve reputation benefits. The number of complaints should decrease as consumers become more knowledgeable and better able to ensure they purchase appropriate products.

The Money Guidance service may prompt increased ‘shopping around’ by consumers which will have an impact on the industry including increasing competition. This has not been quantified as it is a complex area where the overall balance of costs and benefits is likely to be a function of overall industry competitiveness and the price elasticity of customers. Therefore it is impossible to say if it will be an overall cost or a benefit to the industry.

#### *Benefits to Government*

A number of the benefits to Government have been mentioned earlier in this section, including increased take up of social security and a decrease in pension credit in future years. The Government could also stand to benefit from increased tax receipts from the increase in financial services product holding and consumer expenditure that will result from consumers making sound financial decisions and their increased financial capability overall.

#### **Funding for CFEB**

Core funding for CFEB is intended to come from a levy on FSA regulated financial services firms and on relevant OFT-licensed consumer credit firms. This approach follows the Thoresen Review’s recommendation that funding for Money Guidance should come from a broad base of financial services institutions including FSA-regulated firms and consumer credit firms licensed by the Office of Fair Trading (OFT)– we have expanded the approach to cover funding for CFEB’s financial capability activities, including Money Guidance, as a point of policy principle. Further work will be done to determine the principles which OFT will apply to decide which firms should contribute to the costs of Money Guidance.

Funding for CFEB from FSA- regulated firms will be collected via the FSA levy in the same way as funding for the FSA’s work on financial capability has been collected to date. A contribution from relevant OFT-licensed consumer credit firms will be collected via the OFT’s licensing regime in the same way that contributions to the Financial Ombudsman service are collected. This approach, which uses existing levy mechanisms, places no additional administrative requirements on firms.

However, the legislation also provides for CFEB to be able to receive funds from other sources. The Thoresen Review recommended that the costs of the Money Guidance service be split between the Government and the financial services industry. For the pathfinder service, costs have been shared equally between Government and the FSA (i.e. from the levy on FSA-regulated firms). The Government has also committed that funds from the dormant accounts act that have been committed to financial capability would be directed to support implementation of Money Guidance.

On the basis of the current differentiated FSA levy structure and the OFT flat-rate licensing mechanism, the Thoresen Review estimated that FSA-regulated firms would provide 98% of the industry share of funds of a money guidance service with consumer credit firms, licensed by the OFT, providing the remainder. This reflects the limited scope for increases in the flat fee charged under the OFT’s current fee system.

## Funding from FSA-regulated firms

The Deloitte report for Thoresen produced the tables below for funding for Money Guidance. As set out above, overall costs for CFEB are now predicted to be between £37m and £56m in years 1 to 5, similar to the range of costs predicted by the Thoresen Review for Money Guidance alone, these figures are represent an appropriate estimate of the impact of an increase of the FSA periodic fee for regulated firms.

### Indicative view of FSA firms Money Guidance contributor levels

Firm type	Tariff data				Annual fees (2007 / 08)		Indicative GFA contribution p.a.	
	Levy scheme	Fee block	Volume	Units	Description	Value (£)	"Low" scenario (5.70% of periodic fee)	"High" scenario (13.27% of periodic fee)
Larger IFA	FSA	A013	50	Approved persons	FSA periodic fee (£)	£51,000	£3,000	£7,000
	FSA	A018	1,000,000	Annual income				
	FSA	A019	1,000,000	Annual income				
	FOS	I009	50	Relevant approved persons	FOS contribution (£)	£2,000		
	FOS	I016	1,000,000	Relevant business annual income				
	FOS	I017	1,000,000	Relevant business annual income				
	FSCS	A013	50	Approved persons	FSCS contribution (£)	£94,000		
	FSCS	A016	35,000	PIA Pensions Compensation Levy				
	FSCS	A018	1,000,000	Annual eligible income				
FSCS	A019	1,000,000	Annual eligible income					
Insurance Broker	FSA	A019	200,000,000	Annual income	FSA periodic fee (£)	£157,000	£9,000	£21,000
	FOS	I017	200,000,000	Relevant business annual income	FOS contribution (£)	£50,000		
	FSCS	A019	50,000,000	Annual eligible income	FSCS contribution (£)	£9,000		
General Insurer	FSA	A003	150,000,000	Gross premium income	FSA periodic fee (£)	£101,000	£6,000	£13,000
	FSA	A003	250,000,000	Gross technical liabilities				
	FSA	A019	0	Annual income	FOS contribution (£)	£10,000		
	FOS	I002	150,000,000	Relevant adjusted gross premium income				
	FOS	I017	0	Relevant business annual income				
FSCS	A019	0	Annual eligible income	FSCS contribution (£)	£4			
Stockbroker	FSA	A002	0	Number of home finance transactions	FSA periodic fee (£)	£245,000	£14,000	£32,000
	FSA	A007	10,000,000,000	Funds under management				
	FSA	A010	5	Number of traders				
	FSA	A012	500	Approved persons				
	FSA	A014	30	Corporate finance advisers				
	FSA	A018	0	Annual income	FOS contribution (£)	£80,000		
	FSA	A019	10,000	Annual income				
	FOS	I005	10,000,000,000	Relevant funds under management				
	FOS	I007	5	Number of relevant traders				
	FOS	I008	500	Relevant approved persons				
	FOS	I010	30	Relevant corporate finance advisers	FSCS contribution (£)	£112,000		
	FOS	I016	0	Relevant business annual income				
	FOS	I017	10,000	Relevant business annual income				
	FSCS	A007	10,000,000,000	Funds under management				
	FSCS	A010	5	Number of traders				
FSCS	A012	500	Approved persons	FSA periodic fee (£)	£202,000	£11,000	£27,000	
FSCS	A014	30	Corporate finance advisers					
FSCS	A018	0	Annual eligible income					
FSCS	A019	10,000	Annual eligible income	FOS contribution (£)	£72,000			
Credit Card Issuer	FSA	A001	2,500,000,000	Modified eligible liabilities	FSA periodic fee (£)	£202,000	£11,000	£27,000
	FSA	A019	150,000,000	Annual income	FOS contribution (£)	£72,000		
	FOS	I001	8,000,000	Number of relevant accounts				
	FOS	I017	150,000,000	Relevant business annual income				
	FSCS	A019	150,000,000	Annual eligible income	FSCS contribution (£)	£20,000		
Building Society	FSA	A001	3,000,000,000	Modified eligible liabilities	FSA periodic fee (£)	£139,000	£8,000	£18,000
	FSA	A002	25,000	Number of home finance transactions				
	FSA	A012	20	Approved persons				
	FSA	A018	1,500,000	Annual income	FOS contribution (£)	£8,000		
	FSA	A019	3,000,000	Annual income				
	FOS	I001	500,000	Number of relevant accounts				
	FOS	I008	20	Relevant approved persons				
	FOS	I016	1,500,000	Relevant business annual income				
	FOS	I017	3,000,000	Relevant business annual income	FSCS contribution (£)	£5,000		
FSCS	A012	20	Approved persons					
FSCS	A018	1,500,000	Annual eligible income					
FSCS	A019	3,000,000	Annual eligible income	FSA periodic fee (£)	£3,000	£200	£500	
Fund Manager	FSA	A007	40,000,000	Funds under management	FOS contribution (£)	£150		
	FSA	A009	500,000	Gross income				
	FOS	I005	40,000,000	Relevant funds under management	FSCS contribution (£)	£65		
	FOS	I006	500,000	Relevant gross income				
	FSCS	A007	40,000,000	Funds under management				
FSCS	A009	500,000	Gross income	FSA periodic fee (£)	£3,000	£200	£500	
FSA	A018	700,000	Annual income					
FSA	A019	20,000	Annual income					
FOS	I016	700,000	Relevant business annual income					
FOS	I017	20,000	Relevant business annual income					
FSCS	A018	700,000	Annual eligible income	FOS contribution (£)	£100			
FSCS	A019	20,000	Annual eligible income					
Loan Provider	FSA	A019	15,000,000	Annual income	FSA periodic fee (£)	£40,000	£2,000	£5,000
	FOS	I017	15,000,000	Relevant business annual income	FOS contribution (£)	£50		
	FSCS	A019	15,000,000	Annual eligible income	FSCS contribution (£)	£3,000		
Smaller Life Company	FSA	A004	15,000,000	Adjusted gross premium income	FSA periodic fee (£)	£17,000	£1,000	£2,000
	FSA	A004	300,000,000	Mathematical reserves				
	FOS	I004	15,000,000	Relevant adjusted gross premium income	FOS contribution (£)	£2,000		
	FSCS	A004	70,000,000	Relevant Net Premium Income				
Smaller IFA	FSA	A012	2	Approved persons	FSA periodic fee (£)	£3,000	£150	£400
	FOS	I008	2	Relevant approved persons	FOS contribution (£)	£300		
	FSCS	A012	2	Approved persons	FSCS contribution (£)	£500		

Source: FSA data, Deloitte analysis, FSA Fees Calculator (cited in Thoresen Review (March 2008))

### *Administrative Burdens*

It is not believed that this policy results in administrative burdens for business. This is a matter for the FSA which is not bound by the same rules as Government in regard to administrative burdens.

### Specific Impact Tests

The Government considers that these proposals do not have a significant overall impact on competition. Please see page 6 of the evidence base for further discussion of this.

The Government considers that the costs of these proposals do not have a specific impact on small firms.

The Government considers that these proposals will not have any impact on the workload of the courts or legal aid costs.

The Government considers that these proposals do not have an impact on sustainable development.

The Government considers that these proposals will have no significant impact on the emissions of greenhouse gases or other environmental impacts.

As cited above and supported by recent FSA research (annexed), Money Guidance is likely to support improved financial capability, which has been shown to have significant health and well being benefits.

The Government considers that these proposals will not have a specific impact on racial equality.

The Government considers that these proposals do not have an impact on disability equality.

The Government considers that these proposals do not have an impact on gender equality.

The Government considers that the proposals are compatible with the Convention rights protected under the Human Rights Act 1998.

The Government considers that these proposals do not have a significantly different impact in rural areas.

### Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	Yes	No
Carbon Assessment	Yes	No
Other Environment	Yes	No
Health Impact Assessment	Yes	Yes
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	Yes	No

## Annexes

Financial Capability and Wellbeing, FSA Occasional Paper Series 34, May 2009 (see link below)

<http://www.fsa.gov.uk/pubs/occpapers/op34.pdf>

Thoresen Review reports (interim and final) and annexes (including Deloitte Cost-Benefit Analysis) (see link below)

[http://www.hm-treasury.gov.uk/thoresen\\_review\\_index.htm](http://www.hm-treasury.gov.uk/thoresen_review_index.htm)

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Treasury</b>	<b>Title:</b> <b>Impact Assessment of remuneration transparency requirements</b>	
<b>Stage:</b> Final proposal	<b>Version:</b> 1	<b>Date:</b> November 2009
<b>Related Publications:</b> FSB Principles for Sound Compensation Practices Implementation Standards, September 2009; Walker Review of corporate governance consultation paper, July 2009.		

**Available to view or download at:**

<http://www.hm-treasury.gov.uk>

**Contact for enquiries:** Andy Donald

**Telephone:** 020 7270 4725

**What is the problem under consideration? Why is government intervention necessary?**

As part of making improvements to remuneration in the financial services sector it is important that there is appropriate levels of transparency.

Sir David Walker is undertaking a review of corporate governance and will be issuing final recommendations on 26 November 2009. His interim recommendations included increased disclosure of remuneration and it important that the Government has the necessary powers to implement his proposals. Furthermore, the G20 Leaders called for swift implementation of the FSB's Implementation Standards, which includes increased remuneration disclosure.

**What are the policy objectives and the intended effects?**

The policy objective is to promote greater transparency of remuneration in the financial services sector. This is an objective which has been endorsed by the Financial Stability Board and Sir David Walker in his review of corporate governance (based on his interim recommendations published on 16 July).

The intended effect of this clause is to ensure that the UK is in a position to fully implement Sir David's final recommendations and the FSB requirement for increased disclosure.

**What policy options have been considered? Please justify any preferred option.**

Taking powers for HM Treasury to lay subsequent regulations on the disclosure of remuneration.

Extending the Directors' Remuneration Report.

Take no action.

The first option was selected to ensure that the Government has the necessary power to implement the G20 agreement and Sir David Walker's recommendation on transparency. This approach allows disclosure requirements to be imposed on authorised persons or a category of authorised persons.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** Laying regulations under this power will include full consultation and once regulations are in force, in line with good practice, the Government would expect to review the policy within three years.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' The key monetised costs will relate to administrative requirements in compiling and publishing remuneration information. It is not possible to quantify these costs until it has been decided who should be brought within the scope of the regulations. A full impact assessment will be prepared with the regulations.		
	<b>One-off</b> (Transition) <b>Yrs</b>			
	£ N/A			
	<b>Average Annual Cost</b> (excluding one-off)			
	£ N/A		<b>Total Cost (PV)</b>	£
Other <b>key non-monetised costs</b> by 'main affected groups'				

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' It is not possible to quantify the monetary benefits of this power or the regulations that will be made under it as they relate to increased transparency and accountability to shareholders.		
	<b>One-off</b> <b>Yrs</b>			
	£ N/A			
	<b>Average Annual Benefit</b> (excluding one-off)			
	£ N/A		<b>Total Benefit (PV)</b>	£
Other <b>key non-monetised benefits</b> by 'main affected groups' The key non-monetised benefits are enhanced accountability to shareholders, improved director oversight of remuneration, and improved public confidence in respect of financial sector remuneration.				

**Key Assumptions/Sensitivities/Risks**  
 There will be a variance in compliance costs depending on the complexity of the organisation.

Price Base Year	Time Period Years	<b>Net Benefit Range (NPV)</b> £ N/A	<b>NET BENEFIT (NPV Best estimate)</b> £ N/A
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What is the geographic coverage of the policy/option?	UK			
On what date will the policy be implemented?	2010			
Which organisation(s) will enforce the policy?	HMT			
What is the total annual cost of enforcement for these organisations?	£ To be determined			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	Yes			
What is the value of the proposed offsetting measure per year?	£ N/A			
What is the value of changes in greenhouse gas emissions?	£ N/A			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)		
Increase of	£ N/A	Decrease of	£ N/A	<b>Net Impact</b>	£ N/A

Key:      Annual costs and benefits: Constant Prices      (Net) Present Value

## Evidence Base (for summary sheets)

### INTRODUCTION

There is widespread agreement that remuneration practices in banks were a contributory factor in the current market crisis. There is also concern about the lack of transparency around high-end salaries in the financial services sector.

### Select Committee Reports

The Treasury Select Committee, as part of its analysis of the financial crisis published a report on 15 May *Banking Crisis: reforming corporate governance and pay in the City*, which concluded that:

“It is not uncommon for many of the highest paid individuals in an investment bank to be below board level. Despite this, there is currently no disclosure of remuneration for senior and highly-paid individuals who happen not to sit on the board. We believe that there is a compelling case to reform the disclosure rules in the remuneration report of banks and other financial services companies to include disclosure of remuneration of senior managers at sub-board level. Such firms should be required to report details of the remuneration structures in place for high-earning individuals falling within particular pay bands, including the use of deferred bonus payments or clawback mechanisms. The provision of such information is necessary in order to strengthen the ability of shareholders to provide more effective oversight of compensation practices in financial firms and assess the appropriateness of those practices.”

### G20 Agreements

The G20 Leaders’ Summit in London in April 2009 agreed to endorse the Financial Stability Board’s (FSB) principles on compensation. The G20 Finance Ministers’ and Central Bank Governors’ Summit in London in September 2009 concluded that, building on the FSB Principles, there should be, *inter alia*: “[g]reater disclosure and transparency of the level and structure of remuneration for those whose actions have a material impact on risk taking”. The FSB were tasked with reporting to the Pittsburgh G20 Leaders’ Summit with detailed specific proposals for developing this framework, which could be incorporated into supervisory measures, and closely monitoring its delivery.

The FSB presented its document *FSB Principles for Sound Compensation Practices Implementation Standards*, which was fully endorsed by the G20 Leaders at Pittsburgh. The FSB Implementation Standards include the following on disclosure:

An annual report on compensation should be disclosed to the public on a timely basis. In addition to any national requirements, it should include the following information:

- The decision-making process used to determine the firm-wide compensation policy, including the composition and the mandate of the remuneration committee;
- The most important design characteristics of the compensation system, including criteria used for performance measurement and risk adjustment, the linkage between pay and performance, deferral policy and vesting criteria, and the parameters used for allocating cash versus other forms of compensation;
- Aggregate quantitative information on compensation, broken down by senior executive officers and by employees whose actions have a material impact on the risk exposure of the firm, indicating:
  - amounts of remuneration for the financial year, split into fixed and variable compensation, and number of beneficiaries;
  - amounts and form of variable compensation, split into cash, shares and share-linked instruments and other;
  - amounts of outstanding deferred compensation, split into vested and unvested;
  - the amounts of deferred compensation awarded during the financial year, paid out and reduced through performance adjustments;

- new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments; and
- the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person.

The G20 Leaders called on firms to implement these compensation practices immediately and tasked the FSB with monitoring the implementation of the FSB standards and propose additional measures as required by March 2010.

### **The Walker Review of Corporate Governance**

Sir David Walker has been appointed to carry out a detailed review of corporate governance of UK banks and other financial institutions. His terms of reference were to consider and make recommendations to the Government in the following areas:

- The effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively;
- The balance of skills, experience and independence required on the boards of UK banking institutions;
- The effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees;
- The role of institutional shareholders in engaging effectively with companies and monitoring of boards; and
- Whether the UK approach is consistent with international practice and how national and international best practice can be promulgated.

Sir David published a consultation paper *A review of corporate governance in UK banks and other financial industry entities* with a number of recommendations on 16 July 2009 in which he stated that there is “legitimate shareholder and wider public interest in disclosure in relation to this “high end” category of executives which have large business and risk-related responsibilities.” (page 95). His recommendation in his consultation paper was that “[t]he remuneration committee report should disclose for “high end” executives whose total remuneration exceeds the executive board median total remuneration, in bands, indicating numbers of executives in each band and, within each band, the main elements of salary, bonus, long-term award and pension contribution.” His proposals were the subject of public consultation until 1 October 2009 and he will deliver his final report on 26 November. The Government welcomed Sir David’s consultation paper and now looks forward to his final recommendations.

### **PURPOSE**

The purpose of this clause is to enable the Treasury to implement Sir David Walker’s recommendation on transparency once he has delivered his final report. It is also to ensure that the UK is able to comply with the FSB Implementation Standards as endorsed by the G20 Leaders in Pittsburgh which state, among other things, that there should be greater disclosure of remuneration.

Quoted companies are already required to produce and publish a Directors’ Remuneration Report detailing all monies paid to executive and non-executive directors. This clause gives the Treasury power to expand the disclosure regime beyond quoted companies, and to employees who are not directors.

### **COSTS AND BENEFITS**

Making an assessment of the costs and benefits of proposals in this area is inherently difficult. There will however, be a full consultation on regulations made under this power, in which the Government will make an assessment of the costs and benefits based on the specific proposals taken forward.

The costs will primarily relate to an increase in administrative costs for firms that have to disclose information in respect of remuneration. There may also be one off costs in terms of setting up systems

and process to generate the information; however, the Government feels the on-going costs are likely to be minimal.

Benefits of this power and subsequent regulations are inherently hard to quantify as they relate to increased transparency and accountability to shareholders. There is also a benefit in ensuring that the UK is able to fully comply with the FSB's Implementation Standards as endorsed by G20 Leaders and has the requisite powers to implement Sir David Walker's final recommendation in this area.

### **SMALL FIRMS IMPACT TEST**

Smaller firms are not expected to suffer a disproportionate impact from the requirements. Sir David's report relates to large banks and other financial institutions and small firms are unlikely to be brought within the scope of disclosure regulations.

### **ENFORCEMENTS, SANCTIONS AND MONITORING**

The clause provides that regulations made by the Treasury may apply any provisions made in or under the Companies Act 2006 in respect of directors' remuneration reports to executive remuneration reports, with appropriate modifications. This includes provisions creating offences for failure to comply with the requirements for directors' remuneration reports. However, it also makes it clear that the Treasury may not impose stricter penalties for offences applied to executive remuneration reports than the original offence in relation to directors' remuneration reports. The penalty for failure to prepare a directors' remuneration report or for approval of a directors' remuneration report which does not comply with the requirements of the Companies Act is a fine.

### **IMPLEMENTATION AND DELIVERY PLAN**

The Bill sets out the parliamentary procedure to be followed in respect of making regulations. The affirmative resolution procedure must be followed the first time regulations are made. Subsequently the affirmative resolution procedure continues to apply unless regulations are made which reduce the amount of information which has to be disclosed, and do not make the requirements on companies more onerous. Such regulations will be subject to the negative resolution procedure.

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	No	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Treasury</b>	<b>Title:</b> <b>Impact Assessment of remuneration control</b>	
<b>Stage:</b> final proposal	<b>Version:</b> 1	<b>Date:</b>
<b>Related Publications:</b> Reforming remuneration practices in financial services, FSA, August 09; FSB Principles for Sound Compensation Practices Implementation Standards, September 09.		

**Available to view or download at:**

<http://www.hm-treasury.gov.uk>

**Contact for enquiries:** Andy Donald

**Telephone:** 020 7270 4725

**What is the problem under consideration? Why is government intervention necessary?**

The recent market turmoil has demonstrated that remuneration practices were a contributory factor - poor remuneration policies incentivised excessive risk taking. There is widespread agreement that remuneration practices need to be better aligned with risk management and long-term success.

The G20 Summit in Pittsburgh called for swift implementation of the Financial Stability Board's Implementation Standards.

Intervention is required to ensure that the FSA is under a duty to make remuneration rules consistent with effective risk management and the FSB Implementation Standards.

**What are the policy objectives and the intended effects?**

The policy objective is to ensure that remuneration in the financial services sector does not incentivise excessive risk taking.

As part of this, the UK has committed to implementing the FSB's Implementation Standards at the Pittsburgh G20 Leaders' Summit and the FSB will be monitoring the UK's compliance with this.

The intended effects are to improve the alignment between remuneration and risk management and long-term success, and to ensure the UK fully implements the FSB Implementation Standards.

**What policy options have been considered? Please justify any preferred option.**

Taking powers in respect of remuneration for HM Treasury.

Clarifying and strengthening the FSA's role in examining remuneration practices.

Taking no action.

The second option has been selected because it is clear that the FSA, as the regulator, is in the best position to oversee remuneration practices to ensure that they do not incentivise excessive risk taking.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** The Government has asked the FSA to produce an annual report on compliance with its Code of Practice. The implementation of the G20 agreement in individual countries is being monitored by the FSB.

**Ministerial Sign-off** For final proposal Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' The costs attached to this clause will be significant and will include one-off and ongoing administrative and oversight expenses. However, in advance of the FSA's detailed and specific cost benefit analysis it will be difficult and potentially misleading to attempt to quantify these costs.		
	<b>One-off</b> (Transition) <span style="float: right;">Yrs</span>			
	£ N/A			
	<b>Average Annual Cost</b> (excluding one-off)			
	£ N/A	<b>Total Cost (PV)</b>	£	
Other <b>key non-monetised costs</b> by 'main affected groups'				

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' The benefits of this clause are hard to quantify, but are potentially significant as they relate to financial stability objectives, a better alignment between remuneration and effective risk management and enhanced public confidence and in respect of remuneration in the financial services sector.		
	<b>One-off</b> <span style="float: right;">Yrs</span>			
	£ N/A			
	<b>Average Annual Benefit</b> (excluding one-off)			
	£ N/A	<b>Total Benefit (PV)</b>	£	
Other <b>key non-monetised benefits</b> by 'main affected groups' The key non-monetised benefits are enhanced accountability to shareholders, improved director and regulatory oversight of remuneration, and improved public confidence in respect of remuneration in the financial service sector.				

**Key Assumptions/Sensitivities/Risks**  
There will be a variance in costs depending on the complexity of the organisation.

Price Base Year	Time Period Years	<b>Net Benefit Range (NPV)</b> £ N/A	<b>NET BENEFIT (NPV Best estimate)</b> £ N/A
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What is the geographic coverage of the policy/option?	UK wide			
On what date will the policy be implemented?	2010			
Which organisation(s) will enforce the policy?	FSA			
What is the total annual cost of enforcement for these organisations?	£ 300k+			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	Yes			
What is the value of the proposed offsetting measure per year?	£ N/A			
What is the value of changes in greenhouse gas emissions?	£ N/A			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)		
Increase of	£ N/A	Decrease of	£ N/A	<b>Net Impact</b>	£ N/A

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

### INTRODUCTION

There is widespread agreement that remuneration practices in banks were a contributory factor in the current market crisis, through incentivising excessive risk taking. This is an issue that has been considered in a number of forums, both domestically and internationally.

### Select Committee Report

The Treasury Select Committee, as part of its analysis of the financial crisis published a report on 15 May *Banking Crisis: reforming corporate governance and pay in the City*, in which it considered the issue of remuneration structures and made the following recommendations which are relevant here:

“The banking crisis has exposed serious flaws and shortcomings in remuneration practices in parts of the banking sector and, in particular, within investment banking. Whilst the causes of the present financial crisis are numerous and diverse, it is clear that bonus-driven remuneration structures prevalent in the City of London as well as in other financial centres, especially in investment banking, led to reckless and excessive risk-taking. In too many cases the design of bonus schemes in the banking sector were flawed and not aligned with the interests of shareholders and the long-term sustainability of the banks.”

“The Financial Services Authority has confirmed that it intends, if necessary, to impose higher capital requirements on banks and other financial services firms whose remuneration practices do not comply with its code of practice on remuneration in the banking sector. We endorse this approach, but urge the FSA not to shy away from using its powers to sanction firms whose activities fall short of good practice. We believe that alongside a greater willingness to penalise such firms who fall short of good practice, the FSA must also provide regular reports on what action it has taken on remuneration policy in the banks. This would enhance transparency and provide reassurance to the public that changes in remuneration practices within the sector are being enforced.”

### G20 Agreements

The G20 summits have considered the issue of remuneration in the financial services sector. The G20 Leaders' Summit in London in April 2009 agreed to endorse and implement the Financial Stability Board's principles on remuneration. The FSB Principles state there should be: effective governance of compensation; effective alignment of compensation with prudent risk taking; and, effective supervisory oversight and engagement by stakeholders.

The G20 Finance Ministers' and Central Bank Governors' Summit in London in September 2009 concluded that, building on the FSB Principles, there should be:

- Greater disclosure and transparency of the level and structure of remuneration for those whose actions have a material impact on risk taking;
- Global standards on pay structure, including on deferral, effective clawback, the relationship between fixed and variable remuneration, and guaranteed bonuses, to ensure compensation practices are aligned with long-term value creation and financial stability;
- Corporate governance reforms to ensure appropriate board oversight of compensation and risk, including greater independence and accountability of board compensation committees.

The FSB were tasked with reporting to the Pittsburgh Leaders' Summit with detailed specific proposals for developing this framework, which could be incorporated into supervisory measures. The FSB presented its document *FSB Principles for Sound Compensation Practices Implementation Standards*, which was fully endorsed by the G20 Leaders at Pittsburgh. The FSB Implementation Standards deal with the following areas: the governance of remuneration; the link between remuneration and capital; remuneration structure and risk alignment, disclosure of remuneration; and, supervisory oversight of remuneration. The full text of the FSB Implementation Standards is set out in the annex. The G20 Leaders called on firms to implement these compensation practices immediately and tasked the FSB

with monitoring the implementation of the FSB standards and proposing additional measures as required by March 2010.

### **The Walker Review of Corporate Governance**

Sir David Walker has been appointed to carry out a detailed review of corporate governance of UK banks and other financial institutions. His terms of reference were to consider and make recommendations to the Government in the following areas:

- the effectiveness of risk management at board level, including the incentives in remuneration policy to manage risk effectively;
- the balance of skills, experience and independence required on the boards of UK banking institutions;
- the effectiveness of board practices and the performance of audit, risk, remuneration and nomination committees;
- the role of institutional shareholders in engaging effectively with companies and monitoring of boards; and
- whether the UK approach is consistent with international practice and how national and international best practice can be promulgated.

Sir David published a consultation paper *A review of corporate governance in UK banks and other financial industry entities* with a number of recommendations on 16 July 2009, including in respect of remuneration. His proposals were the subject of public consultation until 1 October 2009 and he will deliver his final report on 26 November. The Government welcomed Sir David's consultation paper and now looks forward to his final recommendations.

### **FSA Code of Practice on Remuneration Practices**

The FSA published its Code of Practice on Remuneration Practices in August 2009 which comes into force on 1 January 2010. It therefore covers all payments made after this date, including in respect of the 2009 performance year. The Code is structured as follows: there is a general principle which becomes an FSA Handbook rule with evidential provisions supporting that general rule and further supporting guidance.

#### **PURPOSE**

The purpose of this clause is to ensure that there is full implementation of the FSB Implementation Standards in the UK and reinforce the FSA's ability to ensure that remuneration does not incentivise excessive risk taking. As a result, in the future, firms will not be able to follow unsafe remuneration practices.

#### **COSTS AND BENEFITS**

Making an assessment of the costs and benefits of proposals in this area is inherently difficult.

To gain an indication of the sort of costs that may be associated with this clause reference should be made to the FSA's consultation paper 09/10 *Reforming remuneration practices in financial services* published in March 2009 and available and the FSA's policy statement 09/15 *Reforming remuneration practices in financial services: Feedback on CP09/10 and final rules* published in August 2009. As part of their consultation paper the FSA produced a cost benefit analysis.

#### **COSTS**

The costs that the FSA produced for its cost-benefit analysis provide a useful indication of the level of costs involved with a regulatory approach to ensuring remuneration does not incentivise excessive risk taking.

The costs produced below are used as indicative of those involved with this clause as they only relate to the FSA's code of practice in its current format. Additional rules that the FSA makes to ensure that remuneration policies are consistent with effective risk management and the FSB Implementation Standards will therefore alter the costs detailed here.

The FSA Code currently applies to firms that meet at least one of the following conditions:

- The first condition is that the firm is a UK bank or building society that had capital resources exceeding £1 billion on its last accounting reference date.
- The second condition is that the firm is a BIPRU 730k firm that had capital resources exceeding £750 million on its last accounting reference date.
- The third condition is that:
  - (a) the firm is a full credit institution, a BIPRU 730k firm or a third country BIPRU 730k firm;
  - (b) the firm is part of a group; and
  - (c) on the firm's last accounting reference date total capital resources held within the group:
    - (i) by UK banks or building societies exceeded £1 billion; or
    - (ii) by BIPRU 730k firms exceeded £750 million.

The FSA determined that there would be the following range of incremental compliance costs per firm in relation to their code of practice:

<b>Costs in terms of</b>	<b>One-off</b>	<b>On-going (annual)</b>
Changing the way remuneration policies are set, systems and controls, additional data collection, reporting, and record keeping requirements	£150,000 - £1.5m	£75,000 - £1m
Issuance of an annual remuneration Statement	£5,000 - £0.5m	
Senior management/board or Committee time		£30,000 - £200,000
Enhanced risk management function		£60,000
Adjusting remuneration structures	0 – £0.5m	0 – £0.5m
<b>Total</b>	<b>£155,000 - £2.5m</b>	<b>£170,000 – £2.3m</b>

In producing these costs the FSA spoke to firms, including large retail banks, wholesale-only banks and a building society in March 2009 and asked for an indication of the costs associated with their proposed code.

The incremental impact of the FSA's Code of Practice and subsequent rules will naturally vary across firms depending on what their current approach to remuneration is and therefore what degree of change they need to make to ensure compliance with rules made by the FSA.

The FSA also quantified the costs to itself as a regulator in enforcing a Code of Practice. It noted that supervisors might require annual statements of remuneration policy from the larger firm, or from firms where inappropriate policies have been identified following Arrow visits or other risk identification work. They estimated that the additional supervision time for its current code of practice can be accommodated within the increased resources allocated to supervisory teams under the Supervisory Enhancement Programme. The total cost of this was costs of about £300,000; additional rules made by the FSA as a result of this clause will likely lead to an increase in the level of supervisory costs.

The FSA noted that the application of their Code might distort the labour market as it could affect the relative competitiveness of regulated firms compared to non-regulated firms with regard to attracting talent and highly qualified employees. This applies in a cross-sectoral and international context. They

noted that internationally coordinated action will help to deal with any risks to the UK's international competitiveness. Since the FSA published their Code the G20 has agreed to implement the FSB's Implementation Standards and therefore the issue of regulatory arbitrage had been mitigated. However it remains an issue and the Government will continue to work with its international partners to reduce the risk of regulatory arbitrage.

We do not envisage any change will be made to the tax or national insurance contributions rules on remuneration. The current rules are expected to apply to bonuses paid under the FSA's Code as it stands and any subsequent rules it makes; the exact consequences will therefore depend on how bonuses are structured. The Government will continue to take action should any business attempt to arrange their affairs to avoid or delay paying their fair share of tax.

## **BENEFITS**

The benefits of reducing incentives to take excessive risks in the financial sector are difficult to quantify, given the nature of market confidence and financial stability. In responding to the FSA's consultation on their remuneration code of practice almost all respondents agreed with the need for change to the status quo, recognising gaps in the existing regulatory approach and body of regulation. The vast majority of respondents also agreed that more could be done across the financial services industry to ensure that the incentives of those able to put firms at risk were better aligned with sound risk management.

The key risk issue that this duty deals with is the problem of remuneration incentivising excessive risk taking. The costs of excessive risk taking have led to substantial costs for society and the taxpayer. Therefore, the benefit of acting in this area, although difficult to quantify, is ensuring that remuneration practices do not incentivise excessive risk taking but rather that they incentivise long-term sustainable success.

There is a clear benefit in ensuring that the FSA must make rules which require remuneration policies to be consistent with the effective management of risks and the FSB Implementation Standards. The UK has committed to implementing the FSB standards and the FSB will be monitoring compliance with the UK's implementation. There is thus a clear benefit to the UK in ensuring that we are fully compliant with any international obligations we have made.

This clause extends the FSA's current scope and provides for greater accountability to the Government for its actions as well as providing an obligation to take account of internationally agreed principles. This clause will help to ensure that remuneration practices do not incentivise excessive risk taking.

## **SMALL FIRMS IMPACT TEST**

Smaller firms are not expected to suffer a disproportionate impact from the requirements. They are not currently subject to the FSA Code on remuneration, and they are unlikely to be brought within the scope of FSA regulation on remuneration in future.

## **ENFORCEMENTS, SANCTIONS AND MONITORING**

The FSA will be responsible for monitoring compliance with its Code and any further rules it makes in the area of remuneration.

In the Government's paper 'Reforming financial markets' published in July 2009 the Government asked the FSA to provide an annual report on remuneration practices, including compliance by firms with the new Code. This report will assess whether remuneration practices are likely to lead to a build up of systemic risk, and make recommendations for action if this is thought to be the case.

The G20 in Pittsburgh tasked the FSB with monitoring countries' compliance with the FSB implementation standards.

## **IMPLEMENTATION AND DELIVERY PLAN**

The FSA's Code of Practice was published in August 2009 and comes into force on 1 January 2010. The FSA will therefore need to make relevant amendments to its Code of Practice to ensure that it complies with the requirements contained in this clause.

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	No	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

### **FSB Principles for Sound Compensation Practices Implementation Standards**

Compensation at significant financial institutions is one factor among many that contributed to the financial crisis that began in 2007. Official action to address unsound compensation systems must therefore be embedded in the broader financial regulatory reform program, built around a substantially stronger and more resilient global capital and liquidity framework. Action in all major financial centres must be speedy, determined and coherent. Urgency is particularly important to prevent a return to the compensation practices that contributed to the crisis.

This report responds to the call by the G20 Finance Ministers and Governors to submit to the Pittsburgh Summit detailed specific proposals on corporate governance reforms, global standards on pay structure and greater disclosure and transparency, to strengthen adherence to the FSB Principles for Sound Compensation Practices, issued in April 2009.

The standards set out in this report focus on areas in which especially rapid progress is needed. They do not fully cover all aspects of the FSB Principles but prioritise areas that should be addressed by firms and supervisors to achieve effective global implementation of the Principles. Firms and supervisors should ensure the process of implementation is begun immediately and pursued rigorously in their respective jurisdictions.

Given the commitment to ensure a level playing field, these implementation standards must be rigorously and consistently implemented by significant financial institutions throughout the world.

The FSB will periodically review actions taken by firms and by national authorities to implement the FSB Principles and these standards and assess the extent to which implementation has occurred and has had the intended effects. It will propose additional measures as required no later than March 2010.

The Basel Committee on Banking Supervision, the International Association of Insurance Supervisors (IAIS) and the International Organization of Securities Commissions (IOSCO) should undertake all necessary measures to support and address prompt implementation of these standards.

The aim of these standards is to enhance the stability and robustness of the financial system. They are not to be used as a pretext to prevent or impede market entry or market access.

#### **Governance**

Significant financial institutions should have a board remuneration committee as an integral part of their governance structure and organisation to oversee the compensation system's design and operation on behalf of the board of directors. The remuneration committee should:

- be constituted in a way that enables it to exercise competent and independent judgment on compensation policies and practices and the incentives created for managing risk, capital and liquidity. In addition, it should carefully evaluate practices by which compensation is paid for potential future revenues whose timing and likelihood remain uncertain. In so doing, it should demonstrate that its decisions are consistent with an assessment of the firm's financial condition and future prospects;
- to that end, work closely with the firm's risk committee in the evaluation of the incentives created by the compensation system;
- ensure that the firm's compensation policy is in compliance with the FSB Principles and standards as well as complementary guidance by the Basel Committee, IAIS and IOSCO, and the respective rules by national supervisory authorities; and
- ensure that an annual compensation review, if appropriate externally commissioned, is conducted independently of management and submitted to the relevant national supervisory authorities or disclosed publicly. Such a review should assess compliance with the FSB Principles and standards or applicable standards promulgated by national supervisors.

For employees in the risk and compliance function:

- remuneration should be determined independently of other business areas and be adequate to attract qualified and experienced staff;
- performance measures should be based principally on the achievement of the objectives of their functions.

### **Compensation and capital**

Significant financial institutions should ensure that total variable compensation does not limit their ability to strengthen their capital base. The extent to which capital needs to be built up should be a function of a firm's current capital position. National supervisors should limit variable compensation as a percentage of total net revenues when it is inconsistent with the maintenance of a sound capital base.

### **Pay structure and risk alignment**

For significant financial institutions, the size of the variable compensation pool and its allocation within the firm should take into account the full range of current and potential risks, and in particular:

- the cost and quantity of capital required to support the risks taken;
- the cost and quantity of the liquidity risk assumed in the conduct of business; and
- consistency with the timing and likelihood of potential future revenues incorporated into current earnings.

Subdued or negative financial performance of the firm should generally lead to a considerable contraction of the firm's total variable compensation, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

For senior executives as well as other employees whose actions have a material impact on the risk exposure of the firm:

- a substantial proportion of compensation should be variable and paid on the basis of individual, business-unit and firm-wide measures that adequately measure performance;
- a substantial portion of variable compensation, such as 40 to 60 percent, should be payable under deferral arrangements over a period of years; and
- these proportions should increase significantly along with the level of seniority and/or responsibility. For the most senior management and the most highly paid employees, the percentage of variable compensation that is deferred should be substantially higher, for instance above 60 percent.

The deferral period described above should not be less than three years, provided that the period is correctly aligned with the nature of the business, its risks and the activities of the employee in question. Compensation payable under deferral arrangements should generally vest no faster than on a pro rata basis.

A substantial proportion, such as more than 50 percent, of variable compensation should be awarded in shares or share-linked instruments (or, where appropriate, other non-cash instruments), as long as these instruments create incentives aligned with long-term value creation and the time horizons of risk. Awards in shares or share-linked instruments should be subject to an appropriate share retention policy.

The remaining portion of the deferred compensation can be paid as cash compensation vesting gradually. In the event of negative contributions of the firm and/or the relevant line of business in any year during the vesting period, any unvested portions are to be clawed back, subject to the realised performance of the firm and the business line.

In the event of exceptional government intervention to stabilise or rescue the firm:

- supervisors should have the ability to restructure compensation in a manner aligned with sound risk management and long-term growth; and
- compensation structures of the most highly compensated employees should be subject to independent review and approval.

Guaranteed bonuses are not consistent with sound risk management or the pay-for-performance principle and should not be a part of prospective compensation plans. Exceptional minimum bonuses should only occur in the context of hiring new staff and be limited to the first year.

Existing contractual payments related to a termination of employment should be re-examined, and kept in place only if there is a clear basis for concluding that they are aligned with long-term value creation and

prudent risk-taking; prospectively, any such payments should be related to performance achieved over time and designed in a way that does not reward failure.

Significant financial institutions should take the steps necessary to ensure immediate, prospective compliance with the FSB compensation standards and relevant supervisory measures.

Significant financial institutions should demand from their employees that they commit themselves not to use personal hedging strategies or compensation- and liability-related insurance to undermine the risk alignment effects embedded in their compensation arrangements. To this end, firms should, where necessary, establish appropriate compliance arrangements.

### **Disclosure**

An annual report on compensation should be disclosed to the public on a timely basis. In addition to any national requirements, it should include the following information:

- The decision-making process used to determine the firm-wide compensation policy, including the composition and the mandate of the remuneration committee;
- The most important design characteristics of the compensation system, including criteria used for performance measurement and risk adjustment, the linkage between pay and performance, deferral policy and vesting criteria, and the parameters used for allocating cash versus other forms of compensation;
- Aggregate quantitative information on compensation, broken down by senior executive officers and by employees whose actions have a material impact on the risk exposure of the firm, indicating:
  - amounts of remuneration for the financial year, split into fixed and variable compensation, and number of beneficiaries;
  - amounts and form of variable compensation, split into cash, shares and share-linked instruments and other;
  - amounts of outstanding deferred compensation, split into vested and unvested;
  - the amounts of deferred compensation awarded during the financial year, paid out and reduced through performance adjustments;
  - new sign-on and severance payments made during the financial year, and number of beneficiaries of such payments; and

the amounts of severance payments awarded during the financial year, number of beneficiaries, and highest such award to a single person.

### **Supervisory oversight**

Supervisors should ensure the effective implementation of the FSB Principles and standards in their respective jurisdiction.

In particular, they should require significant financial institutions to demonstrate that the incentives provided by compensation systems take into appropriate consideration risk, capital, liquidity and the likelihood and timeliness of earnings.

Failure by the firm to implement sound compensation policies and practices that are in line with these standards should result in prompt remedial action and, if necessary, appropriate corrective measures to offset any additional risk that may result from non-compliance or partial compliance, such as provided for under national supervisory frameworks or Pillar 2 of the Basel II capital framework.

Supervisors need to coordinate internationally to ensure that these standards are implemented consistently across jurisdictions.

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HMT</b>	<b>Title:</b> <b>Impact Assessment of Recovery and Resolution Plans ('Living Wills')</b>	
<b>Stage:</b> final proposal	<b>Version:</b> 1	<b>Date:</b> November 2009
<b>Related Publications:</b>		

### Available to view or download at:

<http://www.hm-treasury.gov.uk>

**Contact for enquiries:** Barbara Buettner

**Telephone:** 0207 270 4376

### What is the problem under consideration? Why is government intervention necessary?

Financial institutions of all sizes and functions can have knock on effects for the entire system. As set out in 'Reforming financial markets', the Government's strategy for dealing with these systemically significant firms encompasses a number of strands. One key element to this strategy is the focus on stronger resolution arrangements, both in terms of the tools available to the Authorities, where significant progress has been made, but importantly also the preparation and maintenance by systemically significant firms of so called 'recovery and resolution plans' (RRPs).

### What are the policy objectives and the intended effects?

Recovery and resolution plans are a key tool for institutions and authorities to mitigate risk that systemic firms pose to the system, and to promote long-term financial stability. They require firms to prepare for stressed circumstances, and to prepare for their own failure and resolution. RRP's aim to reduce the probability of firm failure (the recovery element), and the impact of firm failure if it does occur on the wider financial system, the economy and the public finances (the resolution element). By allowing firms to fail, RRP's should also address moral hazard.

### What policy options have been considered? Please justify any preferred option.

- A non legislative approach was considered, but legislation was considered necessary/preferable to maintain momentum and provide FSA with adequate cover for its ambitious work;
- Delaying action and await the FSB's work – however Government made a commitment to take this forward, and there is a risk of the international timetable slipping. The FSA pilot will contribute to evidence base for FSB work, and the FSA will have to take into account FSB standards when writing rules;
- Placing a duty on the FSA to produce rules requiring firms to produce RRP's (preferred option)
- Legislate now for rules - dismissed due to insufficient evidence base / regulatory arbitrage
- Glass Steagall/narrow banking split - difficult in practice, and RRP's achieve the same aim;

### When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The detailed rules on RRP's for Banking Act 2009 firms will be prepared by the FSA in 2010 and will be evidence based, subject to the normal consultation process, including detailed cost benefit analysis and impact assessment.

### **Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>C O S T S</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Firms will incur some one off costs in the preparation of of their RRP initially, and some ongoing costs in maintaining these plans. Given that no detailed rules are currently being proposed, these cannot be fully monetised until sufficient evidence has been gathered. The proposed rules will be subject to full costing and impact assessment.
	One-off (Transition)	Yrs	
	£		
	Average Annual Cost (excluding one-off)		
	£		<b>Total Cost (PV)</b> £
Other <b>key non-monetised costs</b> by 'main affected groups'			

<b>B E N E F I T S</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' RRP's are a key element in dealing with systemically significant firms and as such there are significant benefits in preventing failure or managing it in an orderly manner if it does occur that are, however, not readily quantifiable
	One-off	Yrs	
	£		
	Average Annual Benefit (excluding one-off)		
	£ 4 m		<b>Total Benefit (PV)</b> £
Other <b>key non-monetised benefits</b> by 'main affected groups'			

Key Assumptions/Sensitivities/Risks

Price Base Year	Time Period Years	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b>
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What is the geographic coverage of the policy/option?				UK	
On what date will the policy be implemented?				Royal Assent	
Which organisation(s) will enforce the policy?				FSA	
What is the total annual cost of enforcement for these organisations?				£	
Does enforcement comply with Hampton principles?				Yes	
Will implementation go beyond minimum EU requirements?				N/A	
What is the value of the proposed offsetting measure per year?				£ N/A	
What is the value of changes in greenhouse gas emissions?				£ N/A	
Will the proposal have a significant impact on competition?				No	
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline (2005 Prices)</b>				(Increase - Decrease)	
Increase of	£	Decrease of	£	<b>Net Impact</b>	£

Key: Annual costs and benefits (Net) Present

## Wider policy context

### Dealing with systemically significant firms

In its paper of July 2009, 'Reforming financial markets', the Government set out a number of measures to deal with systemically significant and often complex financial institutions, whose failure could represent a significant threat to financial stability. These include strengthened market discipline - better corporate governance and policies on remuneration so that risk is better understood; and enhanced prudential supervision by the FSA – both generally and targeted specifically at large, complex firms.

These measures should go some way towards reducing the *probability* of firm failure. However, the UK is not proposing to pursue a zero-failure regime, which would be neither realistic nor desirable. It is therefore equally important that where firms do reach the point of failure that the Authorities can intervene, and if necessary resolve the firm, in a way that does not damage the wider financial system and put the public finances at risk. As part of the strategy set out in 'Reforming financial markets, the Government therefore proposes two further measures. First, improvements to the overall framework – this will include enhancements to market infrastructure in key markets to reduce the likelihood of contagion effects- this is crucial where a systemically important firm is allowed to fail. Second, stronger resolution arrangements – improvements have already been made to the regulatory toolkit for winding down failed firms for example through the Banking Act 2009, and firms themselves must make recovery resolution plans to manage their own failure.

### Aims of Recovery and Resolution plans

- **Increased financial stability**- by requiring firms to produce plans that set out the range of actions the firm might take to deal with a stress situation (the recovery element), or how the Authorities' menu of resolution options might be applied to the firm in question (the resolution element), and by identifying potential obstacles to action and suggesting possible solutions, a well prepared and maintained RRP should reduce both the *probability* of firm failure, and the *impact* of firm failure when it does occur by ensuring that a firm can be resolved quickly and effectively.
- **Reducing moral hazard** - as noted above, RRP's have arisen as a tool for the mitigation of firm-specific systemic risk. Where a single firm is so large, complex or interconnected that its failure would pose a threat to the financial system as a whole, this creates economic distortions with implications for both markets and the state. For the state, for example, it may be imperative to prevent such systemic firms from failing, leading to significant fiscal costs. For markets, in turn, this creates an implied public subsidy for such firms, with knock on implications such as on competition, and the risk appetite of the firm benefiting from the implicit subsidy. A key policy objective for dealing with systemically significant firms should therefore be to correct this market failure, removing moral hazard and reasserting the operation of market discipline, and RRP's are a key tool in this.
- **Better-managed firms/regulatory incentives**- with possible benefits for the firms in question. The authorities see RRP's and tougher prudential requirements on systemic firms as elements of a comprehensive policy to deal with such firms. The quality of a bank's resolution process should have a direct bearing on supervisors' overall assessment of the prudential risk borne by the firm- the effectiveness of a firm's RRP should be taken in to consideration when calibrating additional capital requirements on the basis of a firm's systemic impact if it gets into difficulty or fails. RRP's should be about preventing firms from being systemically risky, by creating regulatory incentives for firms to avoid this state.

## **Policy proposals**

### **High-level content:**

The recovery and resolution plans will consist of two elements; first, a pre-resolution element consisting of steps towards recovery such as restoring its capital or liquidity position but also de-risking and restructuring plans to prevent failure; and second, a resolution element, setting out steps required to facilitate the application of resolution tools, and including also blueprints and “wiring diagrams” to assist the authorities in planning and executing effective resolution, and further provisions (e.g. continuity arrangements and business information packs) to support administration and wind-down.

### **Provisions in the Bill:**

The Bill makes a number of provisions around RRP, including the following:

- A duty will be placed on the FSA to make rules requiring firms, or authorised persons of a specified description, to produce RRP. The content of RRP will not be defined in legislation, but the Bill does provide for RRP to include the preparation and maintenance of key sets of data/information. The FSA will consult on the detailed rules on RRP in the normal manner, and this will include a full cost benefit analysis.
- The Bill specifies that the FSA must make rules for those authorised firms subject to Part 1 of the Banking Act 2009;
- The Bill provides an order-making power for the Treasury to stipulate to the FSA the dates by which RRP rules must be in place for categories of firms other than those covered by Part 1 of the Banking Act 2009 (authorised firms ‘of a specified description’);
- The FSA is required to consult the Bank of England and the Treasury before preparing draft rules for both recovery and resolution plans;
- The FSA will be required, in drafting rules on RRP, to have regard to any relevant international standards on RRP. By requiring the FSA to take in to account international standards as they develop, opportunities for regulatory arbitrage and detrimental effects for the UK’s competitiveness will be minimised;
- The Bill requires the FSA to consider whether all recovery and resolution plans are satisfactory. In assessing the resolution plans required from firms subject to Part 1 of the Banking Act 2009, the FSA must consult the Bank of England and the Treasury. The Bank of England and the Treasury may notify the FSA of any inadequacies of such a resolution plan and can suggest remedial actions which the FSA must have regard to; and
- The Bill gives the FSA additional enforcement powers related to the collection of information in relation to RRP.

### **Scope**

RRP can be useful tools not only for those firms that are large, complex or systemically significant. The Bill will place a requirement on the FSA to make rules that require authorised firms to produce RRP. This is framed in such a way as to potentially allow the FSA to require such plans from all authorised firms, but the FSA can and is expected to narrow which firms are captured by applying the rules to firms ‘of a specified description’.

This allows the FSA to introduce these RRP gradually and in a proportionate and risk-based manner.

The Bill specifies that the FSA must make rules for those authorised firms subject to Part 1 of the Banking Act 2009. It also provides an order-making power for the Treasury to stipulate to the FSA the dates by which RRP rules must be in place for categories of firms other than those covered by Part 1 of the Banking Act 2009 (authorised firms ‘of a specified description’);

Which other firms are to be covered will have to be specified in rules and will therefore be subject to full consultation.

Separate proposals for investment banks are currently being work up and are due to be published by the Treasury before the end of 2010. The proposals will be implemented by FSA rules, and would be subject to cost benefit analysis and consultation.

### **What is *not* in the Bill:**

The FSA can apply the whole range of its current set of disciplinary measures to a firm in considering the adequacy of its RRP as part of the supervisory process and can use these tools to achieve significant changes in an authorised firm, including restructuring.

However, we are *not* legislating for additional powers for the FSA to force firms to restructure their operations as a result of their RRP. Whether such powers will be necessary or desirable will be considered upon completion of the FSA's pilot work, and progress on the international template being developed by the FSB. Proceeding with the latter ahead of a clear evidence base and international agreement could have significant competitiveness implications for the UK.

### **Evidence base**

The FSA is currently working on guidance for firms to use in developing their RRP. The pilot exercise that the FSA hopes to complete with a small number of firms by mid-2010 will provide the evidence base from which the future rules on RRP will be developed, and will also inform ongoing international work being done by the FSB.

### **Costs and benefits**

The proposals discussed in this impact assessment contain only the high level provisions made in this Bill. It is key to note that ahead of the publication of its draft rules, the FSA will carry out a full Cost Benefit Analysis and impact assessment, and the proposals will be subject to the normal consultation procedures and timelines.

### **Costs**

#### **To firms:**

The requirement on firms to produce and maintain recovery and resolution plans will impose an initial one off cost when the plans are first developed, as well as a smaller but ongoing cost with regards to the maintenance of these plans. These costs will be borne by firms. These costs will be quantified ahead of the consultation on the rules.

There may also be costs for firms where they have to make ex ante changes to remove or mitigate obstacles to recovery and resolution.

As set out above, the FSA aims to have completed a pilot with a small number of large and complex firms by mid 2010. The evidence base gathered from this pilot will give a clearer sense of costs imposed on firms and will inform the consultation on the proposed rules for RRP that the FSA will commence in 2010.

Where the FSA requires the appointment of a 'skilled person' to address shortcomings in the RRP or the provision of data required, this cost will be borne by the firm. This is consistent with current provisions for the appointment of a skilled person under s166 of FSMA.

#### **To the Authorities:**

There will be some cost to the Authorities, particularly the FSA and Bank of England, in the assessment and ongoing monitoring of these plans. Again, the evidence gathered from the FSA's pilot should give a clearer indication of staff time and skill level required to implement this policy.

## **To the UK:**

By requiring the FSA to take in to account international standards as they develop, opportunities for regulatory arbitrage and detrimental effects for the UK's competitiveness should be minimised.

## **Benefits**

In principle, it is difficult to quantify the benefits of RRP and their contribution to **financial stability** and the removal of **moral hazard**.

The disorderly failure of a systemically important firm, a bank or other deposit-taker in particular, can seriously undermine financial stability, especially if this leads to a loss of confidence in other financial institutions, particularly deposit-takers. Given this linkage, not only will the disorderly failure of such a firm have an impact on the firm's customer base, but also on other financial sector participants, and on the wider economy.

The tripartite sees RRP and tougher prudential requirements on systemic firms as elements of a comprehensive policy to deal with systemic firms. In due course, RRP will become an integral part of the FSA's risk assessment toolkit and broader supervisory approach. The quality of a banks' resolution process should have a direct bearing on supervisors' overall assessment of the prudential risk borne by the firm- and a firm with a well prepared and actionable RRP should be easier to supervise, easier to manage in terms of internal risk management processes, and could potentially find this reflected in its capital requirements (internal capital guidance). Conversely, a firm that fails to produce an adequate RRP that clearly identifies obstacles to potential actions and mitigatory measures may have offsetting prudential measures applied to it to mitigate the risk of failure.

Impact on domestic competition- by contributing to the removal of the moral hazard created by the implied public subsidy in systemically significant firms being too big or too important to fail, RRP could indirectly facilitate the removal of barriers to **competition and market entry**.

## **Timing and interaction with international work**

There is no purely domestic solution to the issue - work on recovery and resolution plans will require international coordination to make sure that the largest global firms are all playing by the same rules. However, while recognising the importance of international coordination and agreement, the Government's position is that the UK must take a global lead in implementing the policy, not least because RRP policy must be tailored to the resolution frameworks of individual jurisdictions. In addition, the evidence gathered from the FSA's pilot will inform the international work. Therefore we don't see any concerns with the UK legislation and the FSA pilot happening in parallel with FSB work. And, as set out above, to minimise the potential for regulatory arbitrage, when it drafts its proposed rules we expect the FSA to be mindful of international standards as they develop.

## **Other policy options considered:**

Glass Steagall – the suggestion of an ex ante separation of retail and 'casino' banking

- There is little evidence to suggest that a Glass Steagall type approach of introducing a distinction between commercial and investment banking activity, or imposing artificial restrictions on a financial institutions' size or complexity, would automatically reduce the likelihood of firm failure.
- A fundamental assumption of this type of approach is that there is an absolute size below which a firm can be safely left to fail. Events of the last 18 months have demonstrated that this is clearly not the case. Banks of all sizes – not just institutions above a certain size – have encountered difficulties. Caps on size, therefore, may not be an effective way of managing risk.
- Moreover, some institutions that failed engaged solely commercial lending or investment banking activity, while one of the most significant failures of all – AIG in the US – was not even a bank. The existence of Glass-Steagall provisions would have failed to address these two points.
- While many large, universal, banks lost money on trading activities, they also suffered losses as a result of bad lending, poor corporate governance and risk-management procedures. The latter are examples of basic problems that can exist across both "narrow" and "broad" banks, again transcending the Glass-Steagall divide.

## Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

### Ongoing domestic work

The UK is leading the thinking on RRPs internationally. On 22 October the FSA published a Discussion Paper on dealing with systemically important firms and assessing the aggregate impact of policy responses. The paper sets out the FSA's initial view on the likely content of recovery and resolution plans ('RRPs') which is broadly in line with our views.

The FSA is about to commence a pilot of RRPs with a small number of large UK banks. This project is due to be completed in mid 2010 and the evidence base gathered from this work will inform the subsequent proposals for rules for RRPs, and the international standards as being developed by the FSB.

### Ongoing International work

Given the global nature of the vast majority of systemic firms (and their important role in the international financial infrastructure), UK is prioritising **close engagement and co-ordination with international partners** in coming months. This process has started already with co-coordinated work through the FSB on the resolution of systemic cross-border firms

In March 2009 the Financial Stability Board ('FSB'), agreed a set of Principles for Cross Border Cooperation on Crisis Management. These principles were subsequently endorsed by the G20 Leaders in April. Principle 8 provides that the authorities will 'strongly encourage firms to maintain contingency plans and procedures for use in a wind-down situation (e.g. fact sheets that could easily be used by insolvency practitioners), and regularly review them to ensure that they remain accurate and adequate'. The FSB has a Working Group on Cross-border Crisis Management ('CBCM') chaired by Paul Tucker, Deputy Governor of the Bank of England. The CBCM has produced templates for pre-resolution processes (plans to de-risk firm's balance sheets in distressed scenarios prepared by firms) and post-resolution arrangements (wind-down – 'gone concern' plans to be prepared by authorities). These templates will be piloted on the major firms with cross-border crisis management groups and will be developed further, in line with the outcomes of these pilots. The templates will form the basis of the internationally agreed standards for recovery and resolution plans, which are expected by the end of 2010.

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Treasury</b>	<b>Title:</b> <b>Impact Assessment of short selling powers</b>	
<b>Stage:</b> final proposal	<b>Version:</b> 2	<b>Date:</b> November 2009
<b>Related Publications:</b> FSA Feedback Statement 09/4: Short selling - Feedback on DP09/1		

**Available to view or download at:**

<http://www.hm-treasury.gov.uk>

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**What is the problem under consideration? Why is government intervention necessary?**

Although short selling can promote market efficiency it can, particularly at times of extreme market turbulence, cause inefficiency. FSA evidence suggests short selling can lead to three market failures: market abuse, disorderly markets (potentially leading to a depositor 'run'), and transparency deficiencies. Each of these potential negative impacts of short-selling represent market failures, and FSA research indicates they tend not to be market self-correcting (see DP09/1) and so require Government intervention.

**What are the policy objectives and the intended effects?**

The proposed objective is to reduce short selling market failures. To do this, the government proposes to take two actions: (a) to grant FSA emergency powers of intervention which are independent of its powers on market abuse. This will allow action to address the full range of market failures described above. (b) To grant FSA powers to make a permanent disclosure regime for short positions in UK stocks. The FSA would also be given related information gathering and investigative powers. This proposal creates clear and separate legal powers to impose short selling obligations.

**What policy options have been considered? Please justify any preferred option.**

Direct permanent constraints on short selling were considered but rejected as having far more costs than benefits. The measures proposed are the result of an extensive, ongoing process of consultation by the FSA to develop effective policies to ensure the huge benefits to the economy of continued financial stability at the smallest possible cost to market participants. The UK requires these powers to meet emerging European and global standards. The powers of emergency intervention are currently operable under the Code of Market Conduct but this is sub-optimal as it confines them to market abuse.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** The effectiveness of the legislation will be subject to ongoing review.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option: Short selling proposals</b>	<b>Description: Changes to FSMA to give FSA clear and explicit powers over short selling.</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Systems and controls costs would be incurred by short sellers as a one-off cost. Compliance costs would be incurred by short sellers as annual costs in monitoring their short positions, making disclosures to the market, and seeking legal advice. See evidence based for explanation.
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	£ less than £20m	1	
	<b>Average Annual Cost</b> (excluding one-off)		
£ 4.8m		<b>Total Cost (PV) £ 61m</b>	
Other <b>key non-monetised costs</b> by 'main affected groups' FSA consulted on the opportunity cost (e.g. cost of business strategies) that would be incurred through these measures but external stakeholders were unable to quantify.			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Benefits are presented in ranges and based on a number of assumptions, i.e. potential disruption to capital raising events.
	<b>One-off</b>	<b>Yrs</b>	
	£ N/A	1	
	<b>Average Annual Benefit</b> (excluding one-off)		
£ 106m - £1,066m		<b>Total Benefit (PV) £ 912m - 9,176m</b>	
Other <b>key non-monetised benefits</b> by 'main affected groups' The benefit of avoiding wider financial disruption and market disorderliness are not readily quantifiable.			

**Key Assumptions/Sensitivities/Risks** A baseline of the current regime, already existing via the Code of Market Conduct, is assumed. Further detailed assumptions are in the evidence base.

Price Base Year 2009	Time Period Years 10	<b>Net Benefit Range (NPV)</b> £ 851m-9,115m	<b>NET BENEFIT (NPV Best estimate)</b> £ 4,132 million (mid point)
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	2010				
Which organisation(s) will enforce the policy?	FSA				
What is the total annual cost of enforcement for these organisations?	£ 0				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	N/A				
What is the value of the proposed offsetting measure per year?	£ n/a				
What is the value of changes in greenhouse gas emissions?	£ n/a				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro</td> <td style="width: 25%; text-align: center;">Small</td> <td style="width: 25%; text-align: center;">Medium</td> <td style="width: 25%; text-align: center;">Large</td> </tr> </table>	Micro	Small	Medium	Large
Micro	Small	Medium	Large		
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of £ n/a	Decrease of £ n/a	<b>Net Impact</b> £ n/a

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

### **Market Failure Analysis – What is the problem under consideration and why is Government intervention necessary?**

As noted in Chapter four of 'Reforming financial markets', the Government proposes to amend FSMA so that the FSA's powers to take emergency action to place restrictions on short selling and require disclosure of short selling are independent of their powers in relation to market abuse. Legislating on this specific issue clarifies the landscape for firms and ensures that, in 2012 if our market abuse regime does become fully aligned with the rest of Europe, we will retain this power. This approach recognises the dangers of disorderly markets and the risks to financial stability as well as market abuse and would give the FSA more flexibility in the use of its powers.

Government intervention is necessary because the framework is established in primary legislation (the Financial Services and Markets Act 2000) and so can only be altered by the Government.

FSA evidence suggests short selling can lead to three market failures: market abuse, disorderly markets (potentially leading to a depositor 'run'), and transparency deficiencies. These tend not to be self-remedying and hence Government intervention is necessary.

#### **Market abuse**

Short selling can be used abusively to create misleading signals about the real supply or the correct valuation of a stock. It can also be used abusively in conjunction with 'scaremongering' tactics to push down the price of a stock being shorted. Firms whose existence depends on the confidence of their customers and counterparties in the stability of the institution (e.g. financial sector companies) may be particularly susceptible to market manipulation of this kind, especially in a climate of severe market turbulence and uncertainty.

#### **Disorderly markets**

Investors can over-react (e.g. in the context of a general lack of confidence in some financial services stocks), to short selling signals in the market resulting in disorderly markets on the back of excessive price falls. Such volatility reduces the ability of a firm to raise equity capital or to borrow money.

#### **Transparency deficiencies**

Information about the aggregate short position in a single stock could help the market judge the extent to which short selling is driving the price of that stock and the amount of the overhang that would need to be covered at some point by short sellers purchasing shares. Alternatively (or in addition), information about significant short positions of individual investors could be beneficial in shedding light on the individual funds/participants who were driving trading.

In the absence of mandatory disclosure/reporting requirements this information would normally not be made available to the public because it is private information held by a short seller and it is not normally in his or her interests to disclose (as to do so would incur costs and might subject him/her to the risk of a 'bear squeeze').

#### **Costs and benefits**

A more detailed examination of the costs and benefits of the introduction and existence of a short selling regime and disclosures thereof is contained in the FSA February discussion and June consultation papers.

The policy objective is to reduce short selling market failures. To do this, the government intends to take two actions:

- (a) To grant FSA clear and separate legal powers to impose short selling restrictions that are independent of its powers for market abuse. This emergency power to ban short selling may be invoked in order to protect the stability of the financial system or to maintain confidence in the financial system. This will allow action to address the full range of market failures described above.
- (b) To grant FSA powers to make a permanent disclosure regime for short positions in UK stocks. Forthcoming FSA rules around disclosure may specify the manner the disclosure is to be made and to whom.

The recent FSA proposals in Feedback Statement 09/4 will not change the current short selling disclosure requirements in the short term. Currently, the FSA requires disclosure to the market of net short positions of 0.25% or more of the issued share capital of UK financial sector companies or companies carrying out a rights issue. The FSA is committed to working towards agreement on future transparency requirements at an international level and discussions are ongoing. An agreed disclosure policy across Europe will make better sense for the firms who operate in several countries and who need to comply with these requirements. The FSA will work to develop an agreed European disclosure policy for short selling and the power we are granting the FSA is very much a 'paving power' to introduce a disclosure regime which is harmonised with our neighbours. The details of the disclosure regime, such as the disclosure threshold and to whom the disclosure are made, are still then working policy matters and the FSA have not proposed any rule changes at this stage.

This Impact Assessment deals with a proposed disclosure regime that is wider in scope than the current disclosure regime in that it would cover all UK stocks rather than merely financial sector stocks. The FSA's current regime already requires disclosure of UK financial sector stocks, and permits emergency intervention in the markets to restrict short selling, and that is the appropriate baseline for this Impact Assessment.

### **Costs**

To help estimate compliance costs the FSA carried out a survey of 29 firms with short selling activities and three trade associations. Additionally, it received cost estimates in response to its short selling consultation and discussion papers.

The current cost of complying with the FSA's current disclosure regime is estimated at £72,000 per firm per annum. The FSA's estimates that 400 firms are impacted so the total estimated annual cost of compliance is £72,000 x 400 = £28.8m. The cost to firms of the UK wide disclosure regime is estimated at £84,000 per firm per annum i.e. a total estimated annual compliance cost of £33.6m. The cost differential of introducing the wider disclosure regime is therefore £4.8m.

Based upon the FSA's cost survey, the absolute one-off costs of complying with the wider disclosure regime are estimated at £20 million. However, this is an absolute cost and not relative to the current financial stock regime. It thus represents an upper limit.

### **Benefits**

In principle, it is difficult to quantify the benefits of a short selling transparency regime. This also applies to the potential cost to industry due to the past disruption that has been caused by short selling. We do not know what the market would look like, were there no short selling disclosure regime. It is not possible to know how many cases of market disruption are prevented because market participants changed their trading strategies due to short selling disclosure rules.

Recognising that such quantification is difficult, any analysis of the benefits can only be based on broad ranges and assumptions. One way of estimating the benefits could be to use the following methodology. Let;

R = extent by which the risk of a disruption to a capital raising event is reduced = 2/3

E = the number of UK capital raising events from April 2008 until April 2009 = 24

C = estimated cost to the economy of a disruption to a capital raising event = £10m - £100m

N = the proportion of capital raising issues that are conducted by non-financial firms = 2/3

Multiplying these together will therefore give us an approximate estimated benefit of the proposed widened disclosure regime:

$R \times E \times C \times N = \text{Benefit}$

$2/3 \times 24 \times (\text{£}10\text{m} - \text{£}100\text{m}) \times 2/3 = \text{£}106\text{m} - \text{£}1,066\text{m}$

The remaining question is to examine whether placing these provisions in a different part of FSMA imposes additional costs or benefits. Overall, we consider that there are no additional costs and benefits arising from this exchange. Penalties for firms that chose to engage in short selling ignoring the restrictions and/or disclosure regime that may be in place would go through the FSA enforcement process with no practical change to the sanctions that may be employed. The FSA itself would incur no additional costs, as no additional resource would be needed relative to the baseline (currently one dedicated person already monitoring the temporary short selling provisions). There would be additional compliance costs

incurred costs by industry in modifying their systems and controls to deal with regime with a wider scope relative to the baseline. The intention is that the disclosure regime adopted should be one that is applied on as wide an international basis as possible thereby minimising any competitive impact. A number of countries already have temporary regimes of this sort.

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Treasury</b>	<b>Title:</b> <b>Impact Assessment of additional powers for FSA to suspend and fine certain persons</b>
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**Stage:** final proposal

**Version:** 1

**Date:** October 2009

**Related Publications:** Reforming financial markets, July 2009

**Available to view or download at:**

[www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

**Contact for enquiries:** Scarlett Graham

**Telephone:** 0207 270 5690

**What is the problem under consideration? Why is government intervention necessary?**

Problem: Non-compliance with legally-binding FSA rules, by certain individuals and firms.

Rationale for government intervention: only Government can enforce the law. Consumers will probably not be aware of the non-compliance by firms until it is too late and consumer detriment has been suffered. (There are two ways that the FSA can influence firms to obey the law: increase detection of non-compliance, and increase punishment when it is detected: this addresses the latter as the threat of detection is a lesser deterrent when punishment is insufficient.)

**What are the policy objectives and the intended effects?**

Policy objectives: increase deterrence by increasing the potential punishment for non-compliance. (There are no compulsory additional costs to firms from granting these powers to the FSA, as there are no new or additional requirements on firms.)

**What policy options have been considered? Please justify any preferred option.**

The existing sanctions, and the potential adverse publicity associated with them, are insufficient to deter non-compliance, as profits can be made and do not have to be surrendered.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** The FSA generally undertakes post-implementation reviews.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Legal challenges to FSA decisions leading to legal costs of £500,000 for firms and £500,000 for FSA
	<b>One-off</b> (Transition) <span style="float: right;"><b>Yrs</b></span> £ 0 <span style="float: right;">10</span>		
	<b>Average Annual Cost</b> (excluding one-off) £ 1m		
			<b>Total Cost (PV)</b>
Other <b>key non-monetised costs</b> by 'main affected groups' FSA senior management time deciding whether or not to use these enhanced tools.			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Mis-selling may be deterred to the extent that consumers will benefit by between £800,000 and £6,400,000 per year, which gives a mid-point of £3,600,000. This is on the assumption of 1.6 million advised sales per year.
	<b>One-off</b> <span style="float: right;"><b>Yrs</b></span> £ 0 <span style="float: right;">10</span>		
	<b>Average Annual Benefit</b> (excluding one-off) £ 3.6m		
			<b>Total Benefit (PV)</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' 0			

**Key Assumptions/Sensitivities/Risks**  
 FSA have undertaken research which is subject to caveats - see below

Price Base Year 2009	Time Period Years 10	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £ 22.4m
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What is the geographic coverage of the policy/option?	UK			
On what date will the policy be implemented?	2010			
Which organisation(s) will enforce the policy?	FSA			
What is the total annual cost of enforcement for these organisations?	£ 40,500			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	Yes			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ 0			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro neg	Small neg	Medium neg	Large neg
Are any of these organisations exempt?	No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)	
Increase of	£	n/a	Decrease of	£ n/a
			<b>Net Impact</b>	<b>£ n/a</b>

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

### Proposals

*(1) The power to suspend individuals or firms for misconduct:*

At present, the FSA can prohibit a person from undertaking a certain regulated activity if it considers they are not "fit or proper". The FSA can also vary a firm's permission if they fail the "threshold conditions". But the FSA cannot prevent an individual or firm from carrying out a particular activity, or selling a particular product, as a disciplinary measure. The FSA estimates that it would consider using this power in approximately 10-20 cases per year.

*(2) The power to fine individuals who should have sought approval but did not:*

At present, the FSA can either prohibit an individual if they are not "fit and proper" or fine the firm they work for, but cannot fine the individual. The FSA estimates that it would consider using this power in approximately 5-15 cases per year.

### Benefits

The additional powers listed above will improve deterrence of non-compliance by firms. There are two factors the FSA can use to influence firms' behaviour towards compliance: the detection of non-compliance; and the punishment that can be inflicted. These additional powers will enhance the FSA's ability to penalise firms for misbehaviour by:

- (1) ensuring that firms or individuals cannot profit by continuing to operate in markets in which they have already demonstrated non-compliance;
- (2) increasing the likely cost (and deterrent effect) to individuals of operating without permission in financial markets. For example, this would deter "hit and run" non-compliance, whereby profits are made by non-approved persons who then subsequently withdraw from the market;

### Costs

#### Costs to firms

There are no compulsory additional costs to firms of granting these powers to the FSA, as there are no additional requirements from firms as a result, and they will only apply to firms who are non-compliant with the FSA's rules and where such penalties are appropriate.

There is, however, a potential cost to firms if the FSA used these powers incorrectly - there would be incremental costs to firms if FSA was to use new powers in a disproportionate way, or apply them incorrectly to a firm that was compliant. However, this potential cost to firms is mitigated by both the legal appeals process as well as the FSA's existing processes for setting penalties, which consider both the weight of evidence and proportionality.

In addition, if a firm chose to challenge a decision all the way to the courts, it would incur legal fees. The stronger the penalties, the more likely firms are to challenge verdicts. At present, approximately 12 firms a year challenge FSA decisions in the courts. FSA estimate that two additional challenges might be made per year. If so, and if each challenge costs the firm £250,000 in legal costs (and each also cost the FSA £250,000 in legal costs) the additional cost to firms would be £500,000.

#### Costs to FSA

There would be some cost to the FSA in senior management time to discuss the types of cases in which the new powers should be exercised. There would also be some time spent on a case-by-case basis to determine whether the new powers should be used, but this will be relatively minor.

As mentioned above, there may also be additional costs to the FSA if firms more actively challenge its use of these new powers than they currently challenge decisions. For example, if two additional challenges are made per year, and each cost the FSA £250,000 in legal costs, the additional cost to the FSA would be £500,000.

The marginal additional enforcement cost of this measure is estimated at £40,500 (to train FSA staff, etc.) The FSA's overall enforcement spend in the 2009-10 Business Plan is £43.4 million.

### Research

The FSA has undertaken some research into the overall deterrent effect of both detecting misbehaviour and setting penalties. This research showed that the extent of non-compliance by firms operating in retail markets rises more sharply as penalties are reduced than if the rate of detection is reduced. Overall, the benefit of improving the FSA's ability to impose penalties on firms will achieve better outcomes for markets and consumers.

Numerical estimates of the deterrence effect are difficult to make with accuracy. The effect partly depends on factors that cannot be accurately measured such as the actual prevalence of "cheating" in a particular market and the desire of firms to cheat.

Research available to the FSA relates to retail financial advice and sales markets. For these markets:

- Where there are very low levels of non-compliance, the deterrent effect is necessarily small. The research suggests that, where fines are currently low, a 10 percentage point increase in the (monetary equivalent value of the) penalty imposed can reduce non-compliance by between 10 and 20 percentage points;
- For markets where there is initially much higher levels of non-compliance, the deterrent effect of higher penalties is more substantial: even when detection of non-compliance is very high (80-90% chance of being caught) a 10 percentage point increase in the penalty imposed can reduce non-compliance by around three-quarters.
- Other research also suggests an average loss of around 5% (5 pence in every pound) for advised sales to consumers. For each sale where mis-selling occurs that is subsequently deterred, we could save consumers from 50p to £4 per £100 spent that would otherwise have been lost to them. If this was applicable to the approximately 1.6 million advised sales made in 2008, these powers would save consumers between £800,000 and £6.4 million per annum.

However, there are caveats re the research underpinning these calculations:

- Firstly, the research only looks at this issue indirectly. Therefore a number of results from other studies have been combined; but those studies may not be strictly comparable as they relate to slightly different market segments and types of non-compliance;
- Secondly, the research showing the impact of higher penalties on non-compliance also shows that the effect diminishes as the size of the punishment increases. That is, if the size of the current fine is already large, the additional deterrent effect will not be as great (if the punishment is already big enough to force the firm into bankruptcy, increasing the penalty will have little effect). Nevertheless, FSA punishments are clearly not at these levels, and indeed in the area covered by the proposed new powers, FSA punishments are effectively de minimis;

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

Summary: Intervention & Options		
<b>Department /Agency:</b> HM Treasury	<b>Title:</b> Impact Assessment of consumer redress mechanisms	
<b>Stage:</b> final proposal	<b>Version:</b> 2	<b>Date:</b> November 2009
<b>Related Publications:</b>		

**Available to view or download at:**

<http://www.hm-treasury.gov.uk>

**Contact for enquiries:** Brian Garcia

**Telephone:** 020 7270 5219

**What is the problem under consideration? Why is government intervention necessary?**

Current redress mechanisms are not entirely adequate where a large number of consumers suffer detriment in a similar way. That is why some cases that might be actionable on a group basis are settled individually by the Financial Ombudsman Service or the courts. The take up of collective action has been modest, despite regular mis-selling and other scandals. The number of complaints referred to FOS is expected to rise to 150,000 in 2009-10 and continue to rise during the current economic downturn. Up to 45% of these cases have similar characteristics.

**What are the policy objectives and the intended effects?**

To deliver a package that promotes the restoration of consumer confidence in financial services by:

- (i) addressing the causes of mass complaints before they occur;
- (ii) developing measures to assess consumer redress by the FSA when mass complaints occur;
- (iii) providing new routes to collective redress in order to deal with claims more efficiently, reduce the time that claimants may have to wait, and reduce the volume of appeals to FOS.

What policy options have been considered? Please justify any preferred option.

- (i) do nothing - use existing regulatory procedures
- (ii) new regulatory powers to impose collective settlements
- (iii) a new court based representative actions process
- (iv) a new third party alternative dispute resolution process
- (v) a new tribunal service dedicated to financial services group litigation

A combination of (ii) and (iii) offers a proportionate response that can be tailored to differing circumstances with minimal cost

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** At the next review of the relevant provisions of the Financial Services and Markets Act. No date has been set.

**Ministerial Sign-off** For consultation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' We assume zero additional costs to firms of dealing with claims that would otherwise be handled individually. We assess the potential cost of claims by consumers who currently suffer detriment but do not complain (est 60,000) based on unit costs under the collective redress system..	
	One-off (Transition)	Yrs		
	<b>£ 0</b>			
	<b>Average Annual Cost (excluding one-off)</b>			
	<b>£ 45m - 60m</b>		<b>Total Cost (PV)</b>	<b>£ 451.9m</b>
Other <b>key non-monetised costs</b> by 'main affected groups'				

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' As many as 45% of cases referred to FOS have common characteristics. We assume this number might be dealt with collectively and add an estimate for those who do not currently complain who might come forward. We estimate average size of claims to range from £500 to £10,000.	
	One-off	Yrs		
	<b>£ 0</b>	0		
	<b>Average Annual Benefit (excluding one-off)</b>			
	<b>£ 60m to 300 m</b>		<b>Total Benefit (PV)</b>	<b>£ 1,549.4m</b>
Other <b>key non-monetised benefits</b> by 'main affected groups'				
Consumers: more efficient claims handling, reduced waiting times and reduced FOS caseload. Firms: Legal certainty and appeals process.				

**Key Assumptions/Sensitivities/Risks**  
 It is assumed that the quantum of individual redress will not differ materially, whether secured through individual or collective action.

Price Base Year 2009	Time Period Years 10	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b>
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What is the geographic coverage of the policy/option?		UK			
On what date will the policy be implemented?		Royal Assent			
Which organisation(s) will enforce the policy?		FSA			
What is the total annual cost of enforcement for these organisations?		<b>£ 0</b>			
Does enforcement comply with Hampton principles?		Yes			
Will implementation go beyond minimum EU requirements?		N/A			
What is the value of the proposed offsetting measure per year?		<b>£ 0</b>			
What is the value of changes in greenhouse gas emissions?		<b>£ 0</b>			
Will the proposal have a significant impact on competition?		No			
Annual cost (£-£) per organisation (excluding one-off)		Micro	Small	Medium	Large
Are any of these organisations exempt?		No	No	N/A	N/A

<b>Impact on Admin Burdens Baseline (2005 Prices)</b>		(Increase - Decrease)
Increase of	£ 0	Decrease of
	£ 0	<b>Net Impact</b>
		<b>£ Negligible</b>

Key: Annual costs and benefits: (Net) Present

## Evidence Base (for summary sheets)

The number of complaints referred to the FOS has risen year on year since it was established in 2001. 31,347 complaints were referred for decision in the first year, compared to 127,471 in the year to March 2009, a fourfold increase<sup>2</sup>. The Ombudsman and the FSA expect the volume of complaints to rise during the current economic downturn, as firms struggle to contain costs and boost capital. FOS expects its caseload to rise to 150,000 in 2009-10<sup>3</sup>. The rate at which FOS upholds complaints in the consumer's favour has also risen from the 30%-40% range since 2001, to 80% in 2008-09.

There is further evidence that around half of harmed consumers do not complain<sup>4</sup>; and that consumers suffering hardship are least likely to complain and are most likely to give up when they do.

More than half the complaints to FOS each year are concentrated in a small number of products, headed by mortgage endowments and personal pensions plans<sup>5</sup>, and complaints are attributable to only 20 per cent of regulated firms. This suggests that a relatively small number of products and firms, affecting large numbers of customers, are responsible for driving down confidence in the financial services industry, although they may not be the same products and firms every year. For example, in 2008-09 24% of complaints related to payment protection insurance. A significant proportion of complaints therefore have common characteristics that might be addressed through a collective settlement or group action.

### Costs and benefits

The proposed new powers are contingency powers. There are no set up or on-going costs for Government or industry.

The benefits of extending the FSAs powers to secure collective redress are that consumers would not be required to pursue individual claims and the risk of a logjam of applications to the courts or the Financial Ombudsman Service – a recurrent experience in the financial services sector - would be removed.

There will be cost savings for consumers as a result of dealing with a large number of claims through a scheme or group action, but these will depend on the circumstances, and the numbers and complexity, of claims of each case. There will be savings to firms through a more efficient settlement process, and avoidance of court and FOS fees for dealing with individual claims, as well as legal certainty about their liabilities. Again, they are dependent on the individual case. The compensation awarded through this approach would not be a new cost on business, as firms would expect to be paying compensation anyway.

### Benefits quantification

The number of consumers losing out where there has been a widespread failure, and other remedies have failed, is of the order of 60,000 per year.

This is based on the proportion of claims handled by FOS that have common characteristics, around 45% of the caseload.

The unit cost of dealing with claims by FOS is around £500, with an additional cost to firms of complaints handing of a further £500. It is reasonable to assume a saving of £500 per case if cases are settled collectively.

The estimated saving through a reduced FOS caseload is therefore

$$£500 \times 60,000 = \underline{\underline{£30 \text{ million per year}}}$$

We include the benefits to consumers who currently suffer detriment but do not complain.

The number of affected consumers is in the region of 60,000.

There is no typical or average amount that may be claimed by such consumers. We estimate the average size of claims with common characteristics to range from £500 to £10,000.

The potential benefits to consumers is therefore in the range:

<sup>2</sup> FOS annual reports.

<sup>3</sup> FOS business plan 2009-10.

<sup>4</sup> OFT report: [http://www.offt.gov.uk/shared\\_offt/reports/consumer\\_protection/of992.pdf](http://www.offt.gov.uk/shared_offt/reports/consumer_protection/of992.pdf)

<sup>5</sup> In 2008-09 there were most complaints about payment protection insurance and credit card charges.

$£500 \times 60,000$	= £30 million to
$£5,000 \times 60,000$	= £300 million per year

## Costs quantification

The legal costs of an FSA scheme of a collective action through the courts will depend on the circumstances of each case.

We assume zero additional costs to firms for the costs of dealing with claims that might otherwise be handled individually by the courts or FOS. These costs are of the order of £500 per case and will be incurred irrespective of the redress mechanism applied.

However, more claims may be generated through a collective mechanism than might otherwise be generated on an individual basis if those who do not currently complain are included.

These potential costs are  $£500 \times 60,000$  = £30 million per year

The costs of taking action by the FSA or a representative body will depend on the complexity of each case and the length of any proceedings. It is reasonable to assume that they may be in the region of £250 to £500 per case.

These potential costs range from  $£250 \times 60,000$  = £15 million per year to  $£500 \times 60,000$  = £30 million per year

There is a risk that a body that brings a representative action will incur costs that may not be recovered. This too cannot be estimated.

## Summary

### Benefits

Estimated saving through reduced FOS caseload	£30 million per year
Potential benefits to consumers who do not currently complain:	£30m to £300 million per year
<b>Total</b>	<b>£60m to £300m per year</b>

### Costs

Additional claims generated	£30 million per year
Costs of collective action or scheme:	£15 m to £30 million per year
<b>Total</b>	<b>£45m to £60m per year</b>

The mid-point of costs (52.5m) and benefits (180m) has been used to calculate total (pv) cost and benefit and to give the net benefit calculation.

## Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	Yes	No
Rural Proofing	No	No

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>Department for Business Innovation and Skills</b>	<b>Title:</b> <b>Impact Assessment of credit card cheques</b>	
<b>Stage:</b> Final	<b>Version:</b> 1	<b>Date:</b> October 2009
<b>Related Publications:</b> Regulatory impact assessment, published with "Credit Card Cheques: A Discussion Paper" (DTI), November 2005, URN 05/1770		

**Available to view or download at:**

<http://www.berr.gov.uk/whatwedo/consumers/consumer-white-paper/page52784.html>

**Contact for enquiries:** Valerie Carpenter

**Telephone:** 020 7215 0225

**What is the problem under consideration? Why is government intervention necessary?**

Credit card cheques are a method of accessing money available on a consumer's credit card account. The unsolicited nature of credit card cheques, combined with the numbers sent out, may make it easier for consumers in financial distress to use them and the often high costs associated with credit card cheques can make their situation worse. Evidence suggests that previous action to increase transparency has not been entirely successful in increasing consumer understanding of the associated costs. The market failure rationale in this case is imperfect information, coupled with behavioural biases, as explained below.

**What are the policy objectives and the intended effects?**

The policy objective is to encourage consumers to exercise more control over their financial affairs. The removal of unsolicited credit card cheques should have the positive effect of forcing consumers to behave more proactively regarding their finances, exploring other credit options or deferring/restricting spending, rather than using a credit card cheque.

**What policy options have been considered? Please justify any preferred option.**

The following options have been considered:

- (i) Do nothing
- (ii) Banning unsolicited credit card cheques
- (iii) Banning all credit card cheques

The Government's preferred option is (ii), which would go some way to guaranteeing an appropriate level of consumer protection, while minimising any unintended consequences for fully-informed users of credit card cheques.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** This impact assessment is being prepared for the Financial Services Bill, which enters Parliament in November 2009. This will only be subject to change if there are amendments to the Bill. A post-implementation review will be undertaken in Spring 2013/15.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.*

Signed by the responsible Minister:



Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option: Option 2 - Ban unsolicited credit card cheques</b>	<b>Description: Ban issuers from sending unsolicited credit card cheques to consumers</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Costs to credit card issuers in terms of lost revenue (up to £130m pa); costs to perfectly-informed users from not being willing or able to request credit card cheques (up to £21m pa); lost revenue to printers of credit card cheques (£18m pa)
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	£ -	10	
	<b>Average Annual Cost</b> (excluding one-off)		<b>Total Cost (PV)</b>
£ 18m-169m		Other <b>key non-monetised costs</b> by 'main affected groups' Potential costs to industry to adjust their operating systems to a model based on only solicited credit card cheques; costs to individuals from being unable to use credit card cheques in situations where no alternative is available, and if they do not request them	

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Savings for imperfectly-informed consumers from not having to pay costs associated with use of credit card cheques (up to £130m pa); cost savings to credit card issuers from lower processing and printing costs (£18m pa)
	<b>One-off</b>	<b>Yrs</b>	
	£ -	10	
	<b>Average Annual Benefit</b> (excluding one-off)		<b>Total Benefit (PV)</b>
£ 18m-148m		Other <b>key non-monetised benefits</b> by 'main affected groups' Potential benefits for consumers associated with a reduction in stress and/or health problems associated with the use of credit card cheques, where such use contributes to an increased likelihood of unsustainable levels of debt.	

**Key Assumptions/Sensitivities/Risks**  
 £21m annual costs identified above assumes that all perfectly-informed users would not request credit card cheques; for NPV best estimate, it is assumed that 50% of these potential costs will be realised. Assume that credit card cheque values will decline by average 2005-8 levels (i.e. -8.1%)

Price Base Year 2008	Time Period Years 10	<b>Net Benefit Range (NPV)</b> <b>£ 0 to -131m</b>	<b>NET BENEFIT (NPV Best estimate)</b> <b>£ 0 to -65m</b>
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	2010				
Which organisation(s) will enforce the policy?	Trading Standards				
What is the total annual cost of enforcement for these organisations?	£ Unknown				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	N/A				
What is the value of the proposed offsetting measure per year?	£ N/A				
What is the value of changes in greenhouse gas emissions?	£ N/A				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro Unknown</td> <td style="width: 25%; text-align: center;">Small Unknown</td> <td style="width: 25%; text-align: center;">Medium Unknown</td> <td style="width: 25%; text-align: center;">Large Unknown</td> </tr> </table>	Micro Unknown	Small Unknown	Medium Unknown	Large Unknown
Micro Unknown	Small Unknown	Medium Unknown	Large Unknown		
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> </tr> </table>	No	No	No	No
No	No	No	No		

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of £ 0	Decrease of £ 0	<b>Net Impact £ 0</b>

Key: Annual costs and benefits: (Net) Present

## Summary: Analysis & Evidence

<b>Policy Option: Option 3 – Ban credit card cheques</b>	<b>Description: Ban issuers from sending credit card cheques to consumers</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' Costs to credit card issuers in terms of lost revenue (£130m pa); costs to perfectly-informed users from not being able to use credit card cheques (£21m pa); lost revenue for printers of credit card cheques (£18m pa)
	<b>One-off</b> (Transition) <span style="float: right;"><b>Yrs</b></span>	
	£ - <span style="float: right;">10</span>	
	<b>Average Annual Cost</b> (excluding one-off)	
£ 169m	<b>Total Cost (PV)</b>	<b>£ 1,048m</b>
Other <b>key non-monetised costs</b> by 'main affected groups' Costs to individuals from being unable to use credit card cheques in situations where no alternative is available		

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' Savings for imperfectly-informed consumers from not having to pay costs associated with use of credit card cheques (£130m pa); cost savings to credit card issuers from lower processing and printing costs (£18m pa)
	<b>One-off</b> <span style="float: right;"><b>Yrs</b></span>	
	£ - <span style="float: right;">10</span>	
	<b>Average Annual Benefit</b> (excluding one-off)	
£ 148m	<b>Total Benefit (PV)</b>	<b>£ 917m</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' Potential benefits for consumers associated with a reduction in stress and/or health problems associated with the use of credit card cheques, where such use contributes to an increased likelihood of unsustainable levels of debt.		

**Key Assumptions/Sensitivities/Risks**  
Assume that credit card cheque values will decline by average 2005-8 levels (i.e. -8.1%).

Price Base Year 2008	Time Period Years 10	<b>Net Benefit Range (NPV)</b> £ -131m	<b>NET BENEFIT (NPV Best estimate)</b> £ -131m
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	2010				
Which organisation(s) will enforce the policy?	Trading Standards				
What is the total annual cost of enforcement for these organisations?	£ Unknown				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	N/A				
What is the value of the proposed offsetting measure per year?	£ N/A				
What is the value of changes in greenhouse gas emissions?	£ N/A				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro Unknown</td> <td style="width: 25%; text-align: center;">Small Unknown</td> <td style="width: 25%; text-align: center;">Medium Unknown</td> <td style="width: 25%; text-align: center;">Large Unknown</td> </tr> </table>	Micro Unknown	Small Unknown	Medium Unknown	Large Unknown
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Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> </tr> </table>	No	No	No	No
No	No	No	No		

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of £ 0	Decrease of £ 0	<b>Net Impact</b> £ 0

Key: Annual costs and benefits: (Net) Present

## Evidence Base (for summary sheets)

### Overview

1. Issues around the use of credit card cheques have been considered for some time. Initially, this was considered through the Task Force on Tackling Over-indebtedness<sup>6</sup> and the Treasury Select Committee on Credit Card Charges and Marketing<sup>7</sup>. The second Task Force report in January 2003<sup>8</sup> made a number of recommendations concerning the precautions lenders should take about a customer's financial status before sending out credit card cheques and the information that should be provided concerning the charging arrangements, conditions of use and the difference in protection compared with the use of a credit card. Meanwhile, the Treasury Select Committee made similar recommendations in 2005<sup>9</sup> and also expressed concern about how the unsolicited issuing of credit card cheques had the potential to disproportionately affect households at risk of over-indebtedness.
2. The banning of unsolicited credit card cheques was the subject of a consultation in 2005<sup>10</sup>, following which such a ban was rejected. During the passage of the Consumer Credit Act 2006, it was decided to allow industry to adopt voluntary measures to make charges and fees related to credit card cheques more transparent. However, Government also made the commitment to continue to monitor whether further regulation was necessary in this area.
3. The industry took steps to enhance the information provided to consumers, by introducing a summary box with all credit card cheques to include key information, such as interest rates and handling charges. However, evidence suggests that these voluntary measures have not been entirely successful in increasing consumer awareness to a satisfactory level – for example, there is evidence that the vast majority of users still do not understand the costs associated with the use of credit card cheques.
4. It may also be that many potential users of credit card cheques could be vulnerable, by virtue of their precarious financial position. Furthermore, as the economic downturn may worsen the financial situation for many consumers, those voluntary rules may not be sufficient to address this information problem.
5. The recently published Consumer White Paper<sup>11</sup> aims to achieve these outcomes. It acknowledges the fact that credit card cheques are still useful and suitable products for some consumers, as long as those who use them are aware of the associated costs. However, evidence suggests that awareness among users is low, despite previous action by industry to provide more transparent information on the costs associated with their use. The unsolicited nature of credit card cheques and the volume that are sent out may make it easier for consumers in distress to use them, instead of facing up to their problems and cutting expenditure or seeking more affordable credit; the high costs associated with them can make the situation worse.

### Issue

6. Consumer indebtedness in the UK has increased significantly during the last 10 years – consumers currently owe around £1.4 trillion, up from £600 billion at the turn of the century. The ratio of debt to income has also risen sharply over this period, from 95% to over 150%. The vast majority of this borrowing (£1.2 trillion) is for mortgages on houses, with the remainder (around £230 billion) accounted for by unsecured credit, which includes personal loans, overdrafts, credit cards, store cards and some other forms of specialist lending.
7. According to Bank of England figures for June 2009, credit cards accounted for £54 billion (24%) of outstanding unsecured credit, nearly double the amount in 2000. Credit cards have become increasingly important unsecured credit products, with 63 million cards in circulation as of July 2009<sup>12</sup> (up from 44 million in 2000) and an average of 1.5 cards held per adult in the UK<sup>13</sup>.

<sup>6</sup> Household Survey on the Cause, Extent and Effects of Over-indebtedness; November 2002

<sup>7</sup> <http://www.parliament.the-stationery-office.co.uk/pa/cm200405/cmselect/cmtreasy/274/27402.htm>

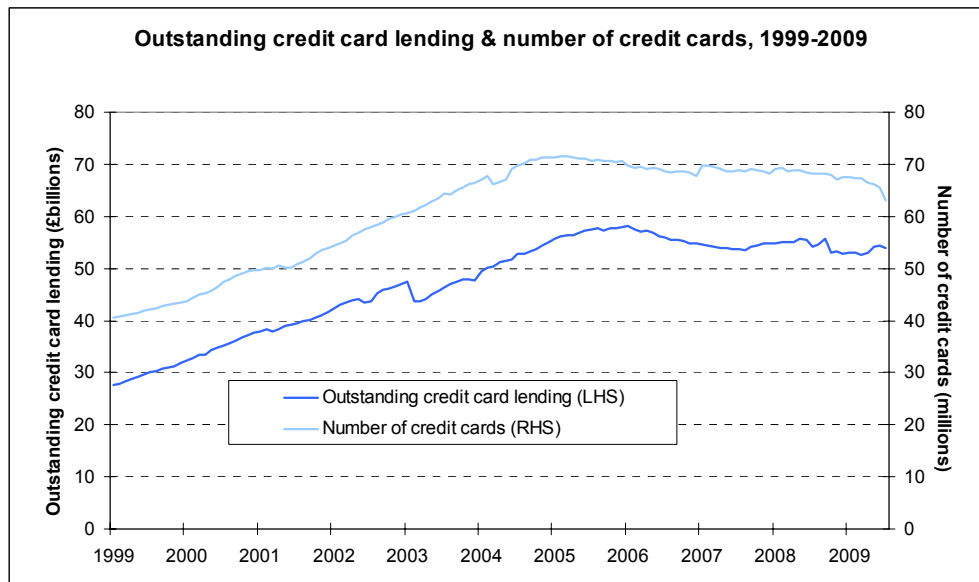
<sup>8</sup> <http://collections.europarchive.org/tna/20031220221849/http://www.dti.gov.uk/ccp/topics1/pdf1/2ndreport.pdf>

<sup>9</sup> <http://www.parliament.the-stationery-office.co.uk/pa/cm200405/cmselect/cmtreasy/274/27402.htm>

<sup>10</sup> <http://www.berr.gov.uk/files/file15331.pdf>

<sup>11</sup> <http://www.berr.gov.uk/whatwedo/consumers/consumer-white-paper/index.html>

<sup>12</sup> Source: BBA



Source: Bank of England and BBA

8. Credit card cheques have been offered by credit card issuers for about 12 years and are an additional way of accessing the credit offered by a credit card. Currently, 9 banking groups offer credit card cheques on at least one of their credit card lines. They are typically used for balance transfers, such as repayment of an outstanding loan from another lender, and for payments to third parties where there are no facilities to use a card. According to YouGov research published by USwitch<sup>14</sup>, 35% of people use credit card cheques for balance transfers, 23% to put cash into their accounts, 16% to pay household bills and 7% to consolidate debts. Evidence from industry suggests that balance transfers account for 31-32% of credit card cheque usage, a further 22% used for cash and 9% for utility bills.
9. Credit card cheques differ from card purchases, in that they are typically treated by the card issuer as cash advances, thereby attracting a fee on issue, usually 2.5% or 3% of the amount of the cheque (though some issuers do not charge a handling fee on their credit card cheques<sup>15</sup>). The interest rate attached to credit card cheques can be higher than the standard purchase rate, such as a cash withdrawal rate<sup>16</sup>, or it may be a lower promotional rate (which may be as low as 0%) for a period. The promotional period is most commonly between 3 and 6 months, or sometimes until the cheque is paid off<sup>17</sup>. Evidence from industry indicates that the average interest rate for credit card cheques can therefore end up being much lower – for example, one issuer had an average interest rate of 6.29% on their credit card cheques in 2008, whilst another said that 80% of its credit card cheques were priced at an APR of less than 8.9%.
10. In addition, there is no interest-free period as with card purchases; interest is charged from the date of the transaction. Unlike card purchases (but in common with cheques drawn on current accounts), joint liability protection under section 75 of the Consumer Credit Act 1974 does not apply to credit card cheques.
11. Evidence from the UK Cards Association<sup>18</sup> indicates that 292 million credit card cheques were issued in 2008 (4.5% more than were distributed in 2007) and 2.7 million were used, representing 0.9% of the total (compared to 1.1% of cheques used a year earlier). The total value of these payments in 2008 was £3.2 billion (£3.6 billion in 2007) and the average value of a cheque was £1,200 (up from £1,141 a year earlier). Survey evidence submitted by industry in response to our consultation indicates that around 4% of credit card holders use credit card cheques, equivalent to 1.3-1.5 million consumers.

<sup>13</sup> Source: UK Cards Association

<sup>14</sup> <http://www.uswitch.com/press-room/?downloadfile=CONSUMERS-SPLURGE-3.6-BILLION%5B1%5D-ON-CREDIT-CARD-CHEQUES>

<sup>15</sup> Such as Abbey, which it is estimated accounts for 2-3% of all credit card cheques (based on their credit card market share – source: Datamonitor; Mintel)

<sup>16</sup> An average APR of 26.7%, according to USwitch

<sup>17</sup> This is usually associated with credit card cheques used for balance transfers. At the end of the promotion period, the interest rate will revert to the cash withdrawal rate or sometimes the purchase rate.

<sup>18</sup> UK Plastic Cards 2009: "The Way we Pay"

12. As can be seen from the table below, compared to 2004 figures, many more credit card cheques are being sent out and less are being used, but the average value of each credit card cheque is increasing (an average value of £850 per cheque in 2004 compared with £1,200 in 2008). Credit card cheques also account for a slightly higher proportion of total outstanding credit card spending – in 2004, just under £3bn was written on credit card cheques, equivalent to 2.9% of all credit card spending<sup>19</sup>, but by 2008, this had risen slightly to 3.1%.

**Table: Number of credit card cheques distributed, volume and value of credit card cheques used, 2004-2008**

Year	Number of credit card cheques distributed (m)	Volume of credit card cheques used (m)	Value of credit card cheques used (£bn)
2004	213.9	3.6 (1.7%)	2.9
2005	257.1	4.3 (1.7%)	4.1
2006	325.9	4.1 (1.2%)	4.0
2007	279.6	3.2 (1.1%)	3.6
2008	292.1	2.7 (0.9%)	3.2

*Source: UK Cards Association*

13. The USwitch research found that 97% of all credit card cheques issued are unsolicited, with 8% of credit card holders receiving credit card cheques once a month and 18% receiving them twice a year. Evidence submitted by industry suggests that the actual proportion of credit card cheques that are unsolicited is 93-94%. However, only a small proportion of credit card cheques received are actually used, as stated above.
14. Evidence from USwitch<sup>20</sup> indicates that 86% of those who use credit card cheques do not know the correct fees for these products, despite action by the industry to provide consumers with more information about the conditions attached to credit card cheques. It also shows that a significant proportion of consumers appear to be using the cheques in ways that might suggest financial distress by, for example, putting cash into their bank accounts and paying utility bills.

### Rationale for intervention

15. The market failure rationale behind Government intervention in this area is that of **imperfect information**. This is supported by the USwitch research, which shows that most consumers do not have a clear understanding of what interests and charges apply when using a credit card cheque. While we acknowledge some consumers might find credit card cheques useful and convenient products, there is a concern that if not understood they could present a great disadvantage for some consumers.
16. The unsolicited nature of credit card cheques, combined with the numbers that are sent out, may make it easier for consumers in financial distress to use them, with the often high costs associated with credit card cheques potentially making their financial situation worse. As stated above, previous action to increase the information provided to consumers does not appear to have been successful in increasing consumer understanding of the associated costs.
17. Evidence from behavioural economics suggests that the unsolicited nature of credit card cheques may be of particular concern. Credit card cheques can be an expensive form of credit when other options are available. However, this can be particularly important if they are sent unsolicited to consumers, as they are more readily accessible. This creates the potential for significant consumer detriment, especially when they are not fully understood.
18. Consumers are prone to certain psychological biases which may impair their ability to make utility-maximising choices. For example, inertia and procrastination can cause problems, particularly in relation to financial decisions<sup>21</sup>. 'Status quo bias', where consumers prefer not to change their current situation, can lead people to routinely prefer the 'default' option.

<sup>19</sup> 2004 figures taken from Regulatory Impact Assessment published with DTI's "Credit Card Cheques: A Discussion Paper", November 2005, URN 05/1770

<sup>20</sup> USwitch press release, 20 November 2008

<sup>21</sup> Another observed bias is bounded self-control, where consumers have limited willpower leading, for example, to impulse purchases, which are later regretted.

19. This quality, combined with cognitive limitations on processing complex and potentially voluminous financial information, can lead to many more consumers receiving a product or service when they do not have to actively 'opt in' to receiving them. This issue is particularly relevant for credit card cheques, as under the current *status quo*, clients receive unsolicited credit card cheques without opting to receive them. They may not be suitable products for obtaining credit given their specific financial circumstances, but they might use them in circumstances of financial distress.

## Objectives

20. The policy objective is to encourage consumers to exercise more control over their financial affairs. By making credit card cheques less readily available, consumers would be forced to give more thought to their financial position, exploring other (potentially cheaper) credit options or deferring/restricting spending rather than using a credit card cheque.
21. The outcomes we would like to see are a significant reduction in the number of credit card cheques sent out and a reduction in the total amount of credit card cheque debt, where it contributes to an increased likelihood of unsustainable debt. There may also be a small increase in the total amount of non-credit card debt if consumers switch their spending to alternative unsecured credit products rather than reduce it. Although a small decrease in the total amount of consumer debt would be expected, it will be very difficult to attribute changes in debt levels to this action alone, in isolation from other factors.

## Options

22. Three options were considered for the purpose of this impact assessment:

- (i) do nothing;
- (ii) ban unsolicited credit card cheques and,
- (iii) ban credit card cheques completely.

23. Industry measures to increase transparency of fees and charges associated with the use of credit card cheques appear not to have worked. Evidence from USwitch indicates that 86% of those who use credit card cheques do not know the correct fees for these products. This is broken down into:

- 23% of users do not know if there is a fee;
- 11% believe there is no fee;
- 13% wrongly believe that there is a standard interest-free period, along with a standard purchase APR; and
- 39% believe there is a handling charge but incorrectly believe there is a standard purchase APR along with the standard interest-free period.

24. On an average cheque value of £1,200<sup>22</sup>, the handling fee would be £30<sup>23</sup>. Assuming that the consumer pays off a credit card cheque over a 12-month period, industry calculations of the associated interest cost are £106.38. However, survey evidence provided by industry indicates that 43% of credit card cheque users pay off their balance in full every month, and so would not incur such significant interest costs. If the purchase was made on the credit card, the total charge would be £81.17 (assuming the balance is paid off over 12 months and the interest rate is the 12-month rolling average credit card rate, based on Bank of England data<sup>24</sup>, which was 12.26%).

25. Therefore, in terms of the unexpected charges experienced by users of credit card cheques, we estimate that, in 2008:

- £27 million were paid by consumers in unexpected handling fees<sup>25</sup>;
- An 'unanticipated' £19.6 million was paid by those consumers (13%) that believed there was no handling fee, a standard interest-free period and standard purchase APR, and
- £27.6 million would have been paid by the 39% of credit card cheque users that thought there was a handling fee but wrongly believed there was a standard purchase APR and a standard interest-free period.

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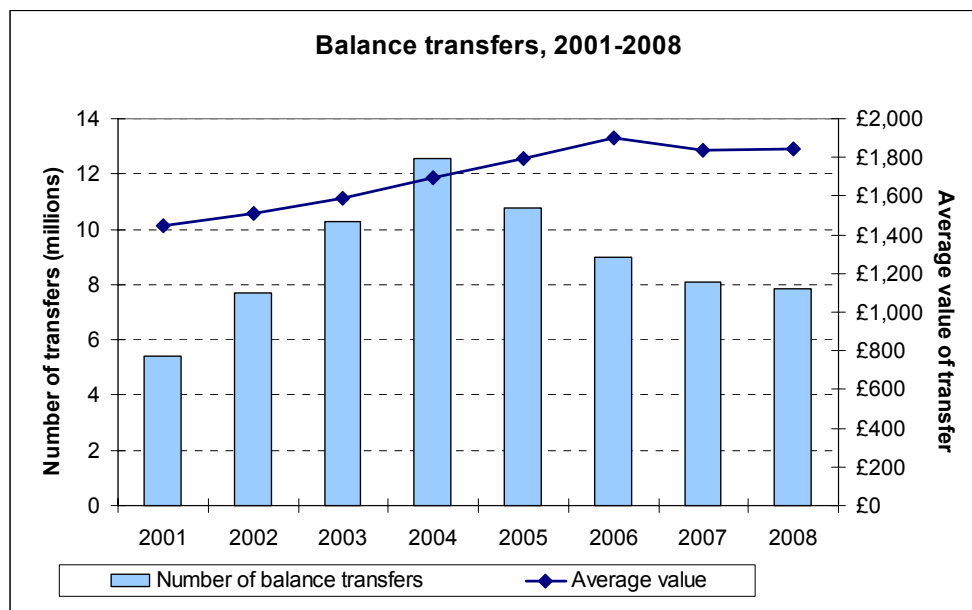
<sup>22</sup> Source: UK Cards Association

<sup>23</sup> Assuming a 2.5% handling fee

<sup>24</sup> Series – CFMHSDP [average, July 2008-July 2009]

<sup>25</sup> 34% of users either thought there was no handling fee, or did not know there was a handling fee; 2-3% do not incur a handling fee (based on Abbey market share)

26. This would mean that the cost to consumers related to unexpected charges amounts to approximately £74 million per year, based on 2008 data. However, given that 43% of credit card cheque users pay off their balance in full each month, the interest costs identified above will only be incurred for one month for those users. This would reduce the costs incurred by credit card cheque users by £28 million.
27. Of the remaining £46 million, we cannot assume that all of this amount would have been saved by increasing the information available. Previous action to give consumers more and clearer information about credit card cheques does not seem to have been entirely successful. Therefore, it is not clear how much additional benefit there would be in further strengthening information provisions.
28. However, there are some instances in which credit card cheques do offer a number of benefits to consumers:
- Well-informed consumers can use them for balance transfers, potentially benefitting from lower interest rates during promotional periods, and
  - Credit card cheques can be used where cards are not accepted, for example to pay small tradesmen<sup>26</sup>.
29. In relation to balance transfers, evidence suggests that around 30% of credit card cheques are used for this purpose. As can be seen from the chart below, balance transfer activity has declined markedly since 2004, but the average value of a balance transfer has remained relatively stable.



Source: UK Cards Association

30. Despite the costs identified above, it is likely that those who use credit card cheques for balance transfers do so because the benefits (in terms of the difference between the interest rate on the cheque and their current credit card, assuming that the latter is higher) exceeds the associated costs (in terms of the handling fee). However, it is difficult to evaluate the scale of those benefits, particularly as they will be traded off against potentially higher interest costs that may be incurred if repayment goes beyond the promotional period.
31. In any case, it is more likely that credit card cheque users who utilise them for balance transfers fall into the category of informed customers – i.e the 14% who understand the costs associated with credit card cheque use.
32. In relation to the second of these benefits, it is very difficult to assess what proportion of credit card cheques are used in situations where cards are not accepted. Industry evidence indicates that around 14-17% of cheques are used for personal cheques, which might be thought to include such

<sup>26</sup> However, as the acceptance of cheques generally continues to decline, this benefit will reduce accordingly

situations. However, it is more likely that these transactions fall into a category of low-value purchases, which could be more likely to be paid off in full every month. Therefore, the associated costs of using credit card cheques in this way is likely to be low.

33. In addition to the 3 options set out below, a further option was considered, of allowing credit card cheques to be sent unsolicited to existing customers who had previously used them (previous use being taken as consent to receive future cheques) and to new customers who opted in to receiving cheques. However, this option was not pursued as it was not considered to meet the policy objective. While such an option has the potential to reduce numbers of new users of cheques (because fewer customers would be offered them), the problems regarding a lack of understanding set out above were identified among current users.
34. Under such an option, the position of those who have used credit card cheques in the past would remain unchanged and there may also be a risk to new users, meaning that the problems of lack of understanding would potentially persist, without further measures to increase their understanding. This could mean that some consumers may have used credit card cheques without fully understanding the associated costs<sup>27</sup>, which would mean that the policy objective had not been achieved.

### **Option 1: Do nothing option**

35. The first option is to do nothing, which would imply maintaining the *status quo*. In this case, issuers would continue to send significant amounts of cheques and consumers will continue to use them, potentially in situations of distress, without understanding the fees and charges that apply to them. The do nothing approach is used in this impact assessment (as is common practice) as the baseline to our analysis

### **Option 2: Ban unsolicited credit card cheques**

36. This is the preferred option. Under this proposal, credit card issuers would be prohibited from sending out cheques except in response to a request from a customer. The credit card issuer could offer to send cheques to the customer but the customer would have to 'opt in' to receiving them. There would not be any restriction on the number of cheques that could be sent out at any one time.
37. Although such action would reduce cheque volumes by 93-97%<sup>28</sup>, evidence indicates that the proportion of received credit card cheques that are actually used is less than 1%<sup>29</sup>. It is difficult to estimate what proportion of the credit card cheques used are unsolicited; it seems unlikely that 93-97% of used credit card cheques are also unsolicited (particularly given the behavioural biases identified above), as this would imply that credit card cheques are equally likely to be used whether they were unsolicited or not.

### **Costs**

38. As a result of implementing this proposal, there would be a transfer of the revenue derived from credit card cheques from credit card issuers to consumers. Potential sources of cost would therefore arise from a loss of consumer surplus for those perfectly-informed consumers that currently use unsolicited credit card cheques and those consumers who use unsolicited credit card cheques where it is not possible to substitute towards payment on a credit card.
39. If users of credit card cheques continued to request the same number of cheques and usage therefore stayed unchanged, there would be no transfer of revenue from credit card issuers to consumers. Equally, at the other extreme, if all credit card cheques currently used are unsolicited, and all credit card cheque usage could be substituted to credit card usage, then all of the revenue generated from handling fees and interest differential between credit card cheques and credit card purchases would be transferred from credit card issuers to consumers (estimated to be £148 million per year).
40. Due to the difficulty in knowing what proportion of credit card cheques currently used are unsolicited, it is difficult to say which of these scenarios might be more likely. Consumers would still be able to request credit card cheques, which might mean that those that use them will continue to request to

<sup>27</sup> This could also potentially hinder their ability to find out whether the expenditure could be funded more cheaply, or even not incurred at all

<sup>28</sup> Based on the proportion of credit card cheques that are unsolicited (source: USwitch, November 2008; UK Cards Association)

<sup>29</sup> Based on 2008 figures (source: UK Cards Association)

receive them. However, the 'status quo bias' identified above means that the number actually taking the time to make that request might be lower than one might expect given their usage; this may change over time as consumers get used to the idea of having to request cheques.

41. Therefore, the revenue lost by credit card issuers – that will be transferred to those credit card cheque users that are imperfectly informed<sup>30</sup> – could be **up to £130 million per year**<sup>31</sup> (depending on the proportion of currently-used credit card cheques that are also unsolicited), amounting to **up to £805 million over 10 years**<sup>32</sup>, discounted at a standard rate of 3.5%<sup>33</sup>.
42. There would also be a cost for some fully-informed consumers who derive financial benefits from using credit card cheques – the USwitch survey evidence suggests that around 14% of credit card cheque users are fully aware of all associated fees and charges. Given that these consumers are willing to pay the costs of using credit card cheques, economic theory would suggest that the value they attribute to this product/service is at least equal to that amount of money. In the worst possible case, if the 14% of credit card cheque users that are perfectly informed only use unsolicited credit card cheques do not request them under an 'opt-in' scenario, this would indicate that these consumers could stand to lose **up to £21 million per year**, or a **maximum of £131 million over 10 years**.
43. This calculation assumes that purchases that would have been made with a credit card cheque can be conducted with a credit card; however, this is unlikely to always be an available payment option. It is very difficult to quantify the proportion of credit card cheques that are currently used in situations where there is no alternative payment option, and the consumer would not request credit card cheques under an 'opt-in' scenario.
44. Similarly to the transfer of revenue identified above, there would also be a transfer between firms that print and dispatch credit card cheques (a cost in terms of lost revenue) and credit card cheque issuers (a benefit in terms of a cost saving). According to 2008 figures, this means that nearly 290 million cheques will not be needed. If each batch of cheques costs 25p to print and dispatch (assuming 4 cheques in a batch; figures used in 2005 RIA), this suggests lost revenue of approximately **£18m per year** which, over a 10-year period discounted at a standard rate of 3.5%, would be **£112 million**. This benefit and cost will therefore offset each other for no net impact on the overall cost-benefit analysis for this option.

### *Benefits*

45. As discussed earlier, there would be savings to those credit card cheque users (that are imperfectly-informed) from not incurring charges associated with credit card cheques. This would be equal to the lost revenue previously identified – i.e. **up to £130 million per year**, amounting to a **maximum of £805 million over 10 years**.
46. As set out above, there would be savings to credit card issuers from less cheques being sent out to consumers, though this would approximately equal the lost revenue for companies who print and dispatch credit card cheques – i.e. approximately **£18m per year**, amounting to **£112 million over 10 years**.
47. There could also be benefits to consumers from a reduction in the incidence of problems associated with over-indebtedness (e.g. health problems, relationship breakdown), in which credit card cheques may play a contributory role. It is very difficult to quantify these benefits and we have not been able to do so here.

### **Option 3: Ban credit card cheques completely**

48. A third option would be to ban the use of credit card cheques completely. Lenders would not be allowed to provide cheques to their customers under any circumstances.

### *Costs*

49. Similarly to the previous option, there would be a transfer of the revenue derived from credit card cheques from credit card issuers to consumers but in this case it would be the maximum amount, i.e. for all credit card cheques (**£130 million per year, £805 million over 10 years**).

<sup>30</sup> 86% of credit card cheque users, according to the USwitch research

<sup>31</sup> Calculation based on difference between interest costs for credit card cheques (£106.38, according to industry calculations) and credit card purchases (based on an interest rate of 12.26%), and an average handling fee of 2.5%

<sup>32</sup> Assuming that aggregate credit card cheque values continue to decline at the same rate as from 2005-8 (-8.1%)

<sup>33</sup> [http://www.hm-treasury.gov.uk/d/green\\_book\\_complete.pdf](http://www.hm-treasury.gov.uk/d/green_book_complete.pdf)

50. Other potential sources of cost would therefore arise from a loss of consumer surplus for those perfectly-informed users of credit card cheques and those consumers who currently use credit card cheques, where it is not possible to substitute towards payment on a credit card (or any other alternative).
51. Similarly to option 2, the costs for fully-informed consumers who derive financial benefits from using credit card cheques would be approximately **£21 million per year**, amounting to **£131 million over 10 years**.
52. There would be also be costs in terms of lost revenue for those firms that print and dispatch credit card cheques, the same as those outlined for Option 2 above – i.e. **£18m per year; £112 million over 10 years**.
53. Again, it is very difficult to quantify the proportion of credit card cheques that are currently used in situations where there is no alternative payment option and it has not been possible to do so here.

#### *Benefits*

54. The benefits to industry for this option would be the same as those outlined for Option 2 above – i.e. a cost saving for issuers of credit card cheques equal to the revenue lost by printers and distributors of credit card cheques (**£112 million over 10 years**).
55. As for option 2, there would be savings to those credit card cheque users (that are imperfectly-informed) from not incurring charges associated with credit card cheques. This would be equal to the lost revenue previously identified – i.e. **up to £130 million per year**, amounting to **£805 million over 10 years**. Again, there could also be benefits to consumers from a reduction in the incidence of problems associated with over-indebtedness (e.g. health problems, relationship breakdown), in which credit card cheques may play a contributory role. It is very difficult to quantify these benefits and we have not been able to do so here.

#### **Risks**

56. The risk of Option 1 is that more consumers will continue to incur the cost of using credit card cheques because of the easy availability of credit card cheques and the fact that many do not understand the true cost of using them.
57. The risks of Option 2 are that, although consumers who use cheques to their advantage will continue to do so, the loss of revenue for issuers may lead to increased rates for all users and the credit card cheque may even disappear altogether if this leads to a sharp decline in usage, which would render the product unprofitable.
58. Under Option 2, the risk associated with consumer incurring costs of using credit card cheques should be mitigated by the fact that issuers will still be able to offer cheques to customers and customers will still be able to request them. The 'status quo bias' suggests that most customers will not use cheques if they have to ask for them, but this behaviour may change if cheques are only available on request and as customers get more used to the idea of asking for them.
59. The risks of increasing interest rates on credit cards (and credit card cheques) and the possibility of credit card cheques disappearing will be influenced by the number of customers who request and continue to use cheques and (in the case of the latter) by the replacement of credit card cheque purchases by credit card purchases. A relevant factor here is the general acceptance of cheques, which is on the decline.
60. The risks of Option 3 are the same as the first two risks identified for Option 2, but without the mitigating factors.

#### **Enforcement**

61. The proposed new provision would be enforced by Trading Standards. A lender guilty of the offence of sending out unsolicited credit card cheques is liable to a fine. Civil sanctions will also be an option. Enforcement will be compliant with the Hampton Code, and will be conducted in a fair, open and transparent manner. There is already a detailed legal framework in place for consumer credit and those offering credit card cheques are already required to hold a consumer credit license from the Office of Fair Trading and to comply with a number of legal requirements. In terms of monitoring, a post-implementation review will be undertaken to examine the impact of the measure, which will be undertaken in Spring 2013/15.

## Recommendation and Summary Table of Costs and Benefits

62. Option 2 is the recommended option as it achieves the policy objective with the best balance of costs and benefits.

Option	Costs	Benefits
1 – Do nothing	n/a	n/a
2 – Ban unsolicited credit card cheques	<p>Costs to credit card cheque issuers from lost revenue associated with imperfectly-informed users of <b>up to £805 million</b></p> <p>Costs to fully-informed users of credit card cheques (who do not request them) of <b>up to £131 million</b></p> <p>Lost annual revenue for printers of credit card cheques of approximately <b>£112 million</b></p> <p>Costs to consumers from not being able to use a credit card cheque where it is not possible to use an alternative payment mechanism (assuming that they do not request to receive credit card cheques)</p>	<p>Savings for imperfectly-informed users associated with credit card cheques of <b>up to £805 million</b></p> <p>Cost saving for credit card cheque issuers in printing costs of approximately <b>£112 million</b></p> <p>Potential benefits from reduced incidence of over-indebtedness that is contributed to by use of credit card cheques</p>
3 – Ban credit card cheques completely	<p>Costs to credit card cheque issuers from lost revenue for imperfectly-informed users of <b>£805 million</b></p> <p>Costs to fully-informed users of credit card cheques (who cannot request them) of approximately <b>£131 million</b></p> <p>Lost revenue for printers of credit card cheques of approximately <b>£112 million</b></p> <p>Costs to consumers from not being able to use a credit card cheque where it is not possible to use an alternative payment mechanism</p>	<p>Savings for imperfectly-informed users associated with credit card cheques of <b>£805 million</b></p> <p>Cost saving for lenders in printing costs of approximately <b>£112 million</b></p> <p>Potential benefits from reduced incidence of over-indebtedness that is contributed to by use of credit card cheques</p>

### Implementation

63. Implementation guidance to industry will be issued before the provision comes into force. When this will be precisely depends on the passage of the Financial Services and Business Bill. As discussed earlier, a post-implementation review will be undertaken in Spring 2013/15.

### Monitoring and evaluation

64. In terms of monitoring, a post-implementation review will be undertaken to examine the impact of the measure, in Spring 2013/15. Data will continue to be collected on credit card cheque usage – key variables could include: the number and value of credit card cheques used, and reasons for requesting credit card cheques.

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

### **Competition Assessment**

Our preferred option will be likely to affect some credit card issuers more than others as some do not issue credit card cheques and the frequency is different amongst those who do. However, consumers using a credit card cheque are already holders of a credit card issued by the same institution. The fact that unsolicited credit card cheques are banned would not, in principle, have an effect on competition since the consumer would still be able to use a credit card issued by the same institution if desired.

### **Small Firms Impact Test**

The prohibition on sending unsolicited credit card cheques will not affect small firms as none of the companies that provide credit card cheques qualify as small firms.

### **Race Equality**

After initial screening as to the potential impact of this policy/regulation on race equality, it has been decided that there will not be a major impact upon minority groups in terms of numbers affected or the seriousness of the likely impact.

### **Disability Equality**

After initial screening as to the potential impact of this policy/regulation on disability equality, it has been decided that there will not be a major impact upon minority groups in terms of numbers affected or the seriousness of the likely impact.

### **Gender Equality**

After initial screening as to the potential impact of this policy/regulation on gender equality, it has been decided that there will not be a major impact on gender in terms of numbers affected or the seriousness of the likely impact.

### **Legal Aid**

After initial screening as to the potential impact of this policy/regulation on legal aid, it has been decided that there will not be a major impact on legal aid.

### **Human Rights**

After initial screening as to the potential impact of this policy/regulation on human rights, it has been decided that there will not be a major impact on human rights.

### **Rural Proofing**

After initial screening as to the potential impact of this policy/regulation on rural proofing, it has been decided that there will not be a major impact on rural areas.

### **Health Impact Assessment**

After initial screening as to the potential impact of this policy/regulation on health, it has been decided that there will not be a major impact on the health of the population.

### **Sustainable Development/Environmental Impact**

After initial screening as to the potential impact of this policy/regulation on the environment, it has been decided that there is potential for the banning of unsolicited credit card cheques to reduce the amount of paper and other resources associated with the printing of the cheques. Our preferred option would

prevent issuers from printing cheques unless the consumer requests them therefore reducing the amount of cheques produced with potential positive impact on the environment, this impact has however not been quantified for the purpose of this impact assessment.

## Sensitivity Analysis

It has been assumed under the analysis for options 2 and 3 that approximately 14% of credit card cheque users are perfectly informed, and that such consumers would therefore suffer costs associated with the banning of (unsolicited) credit card cheques (assuming that they do not request them).

If this assumption were to be increased to 20%, then the costs for these consumers would be approximately £30m per year, or **£187m over 10 years**. If this assumption were decreased to 10%, then the costs for these consumers would be approximately £15m per year, or **£94m over 10 years**.

A further assumption for the analysis of options 2 and 3 is the likely decline in credit card cheques, which is based on the average decline in the aggregate value of credit card cheques between 2005 and 2008 (-8.1%). This then impacts on all the major costs and benefits:

- transfer of revenue for imperfectly-informed users of credit card cheques (£130m per year; £805m over 10 years);
- costs to fully-informed users (£21m per year; £131m over 10 years);
- transfer of revenue from printing/distribution of credit card cheques (£18m per year; £112m over 10 years).

If this assumption were to be increased to -10%, then the overall impact would be:

- transfer of revenue for imperfectly-informed users of credit card cheques (£130m per year; £748m over 10 years);
- costs to fully-informed users (£21m per year; £122m over 10 years);
- transfer of revenue from printing/distribution of credit card cheques (£18m per year; £104m over 10 years).

The overall impact of this change, in terms of its effect on net benefits of the proposals would be:

- Option 2 = 0 to -£122m
- Option 3 = -£122m

If this assumption were to be decreased to -6%, then the overall impact would be:

- transfer of revenue for imperfectly-informed users of credit card cheques (£130m per year; £873m over 10 years);
- costs to fully-informed users (£21m per year; £142m over 10 years);
- transfer of revenue from printing/distribution of credit card cheques (£18m per year; £121m over 10 years).

The overall impact of this change, in terms of its effect on net benefits of the proposals would be:

- Option 2 = 0 to -£142m
- Option 3 = -£142m

Under option 2, a small additional burden for users and issuers associated with the request of credit card cheques may be created, though this is unlikely to be substantial and no attempt has been made to quantify it here.

## **Vulnerable consumers**

Although we do not have evidence on the demographic characteristics of credit card cheque users, such users may be in a vulnerable position, by virtue of their financial position. Previous research has found that credit card cheques were sent to above-average proportions of cardholders in financial difficulties<sup>34</sup>. Such action may inadvertently exacerbate a household's precarious financial situation, potentially pushing them into a position of over-indebtedness, although credit card issuers argue that they have tightened up their risk profiling considerably in recent years and do not send credit card cheques to those in financial difficulties.

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<sup>34</sup> HM Treasury Select Committee: Transparency of Credit Card Charges, First Report of Session 2003-4

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Treasury</b>	<b>Title:</b> <b>Impact Assessment of Expanding the role of the FSCS to act as a paying agent for other compensation schemes or arrangements</b>	
<b>Stage:</b> final proposal	<b>Version:</b> 2	<b>Date:</b> 26 October 2009
<b>Related Publications:</b> 'Reforming financial markets'		

**Available to view or download at:**

<http://www.hm-treasury.gov.uk/d/impactassessment080709.pdf>

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**What is the problem under consideration? Why is government intervention necessary?**

In 2008 the FSCS went beyond its formal remit to ensure that eligible claimants in failed banks were fully compensated for their deposits, including those in the UK (Icesave) branch of the Icelandic bank Landsbanki and in the UK bank London Scottish by paying the compensation due from the Icelandic deposit-guarantee scheme and the amounts the Government provided to ensure that eligible depositors in both banks were fully compensated for their deposits. Government intervention is needed as FSCS must be given the necessary power in legislation. It cannot happen by private agreement.

**What are the policy objectives and the intended effects?**

The policy objective is to put the ability to make such arrangements on to a proper permanent footing. This would have the effect of making it easier to bring in such arrangements if they were necessary in any future crisis. This would also provide a framework for bringing in a 'single point of contact' system for provided compensation in the event of default of institutions based in EU member states which operate cross-border through branches in other member states.

**What policy options have been considered? Please justify any preferred option.**

The options are 'do nothing' and the preferred option, described above. The preferred option is justified by the ability to make such arrangements more efficiently when a proper framework is already in place.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** The proposed option would only make possible putting in place compensation arrangements if they were needed in future. It is not possible, therefore, to set a review date.

**Ministerial Sign-off** For consultation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' See following section. This analysis assumes that arrangements to pay compensation are to be made. So it starts from the actual (but unknown) costs of ad hoc arrangements not from the (zero) cost of no arrangements being put in place.	
	<b>One-off</b> (Transition)	<b>Yrs</b>		
	£			
	<b>Average Annual Cost</b> (excluding one-off)			
	£		<b>Total Cost (PV)</b>	£ nil
Other <b>key non-monetised costs</b> by 'main affected groups'				

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' See following section. There should be savings in the cost of running ad hoc arrangements to pay compensation etc; and benefits to customers in terms of faster access to compensation.	
	<b>One-off</b>	<b>Yrs</b>		
	£	10		
	<b>Average Annual Benefit</b> (excluding one-off)			
	£ 110,000		<b>Total Benefit (PV)</b>	£ 946,845
Other <b>key non-monetised benefits</b> by 'main affected groups' The proposed option could be seen as a simplification measure. All those benefits are in principle captured in the monetised benefits. Any other simplification benefits are likely to be negligible.				

**Key Assumptions/Sensitivities/Risks** Assumptions about: costs for setting up an ad hoc compensation scheme; split between fixed and variable costs; numbers of persons compensated; reduction in payment delays, amounts of compensation and interest rates.

Price Base Year 2009	Time Period Years 10	<b>Net Benefit Range</b> (NPV) £	<b>NET BENEFIT</b> (NPV Best estimate) £ 946,845
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What is the geographic coverage of the policy/option?	Not applicable			
On what date will the policy be implemented?	2010/2011			
Which organisation(s) will enforce the policy?	Not applicable			
What is the total annual cost of enforcement for these organisations?	£ N/A			
Does enforcement comply with Hampton principles?	N/A			
Will implementation go beyond minimum EU requirements?	N/A			
What is the value of the proposed offsetting measure per year?	£ Not applicable			
What is the value of changes in greenhouse gas emissions?	£ Nor applicable			
Will the proposal have a significant impact on competition?	Yes/No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	N/A	N/A	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)		
Increase of	£ n/a	Decrease of	£ n/a	<b>Net Impact</b>	£ Negligible

Key:

Annual costs and benefits: Constant Prices

(Net) Present Value

## Evidence Base (for summary sheets)

The FSCS is responsible for paying the compensation provided for in its rules (which are made by the FSA) to eligible claimants. This includes paying compensation to depositors with the UK branches of credit institutions from other EEA states that have joined the 'top-up' arrangements allowed under the EC Deposit-guarantee Schemes Directive. But under this directive, the deposit-guarantee scheme in the credit institution's home member state is responsible for paying all or part of the total compensation to the claimant. So in theory the claimant might have to deal with the FSCS and a foreign scheme (or possibly just with the foreign scheme) to claim compensation. Similarly, if the Government or some other person provides additional compensation above what the FSCS is required to provide, it would mean in theory that the Government or that other person had to make entirely separate arrangements.

This could be inefficient and costly, and delay payments to those receiving compensation. This could also, therefore, damage investor confidence.

The effect of the proposal is that the FSCS would act as paying agent in new situations on behalf of other organisations who have to pay compensation. These organisations would have to meet all the compensation costs and additional management expenses so there would not be any increase in the levies the FSCS raises from the financial services industry. The assumption is that the FSCS would have lower management expenses (i.e. resource costs) than other ways of paying compensation on an *ad hoc* basis than a separate, deliberately created mechanism to pay compensation.

There are, therefore, no compliance costs arising from this proposal that would fall directly on financial services or other businesses (or on other private sector organisations). Of course, businesses (and others) may be direct or indirect contributors to any compensation that is paid and to the resource costs incurred in making arrangements for compensation payment. But no assumptions can be made about how those contributions would be collected or the compliance burden that might result.

### **Detailed assumptions and calculations**

This proposal envisages using the FSCS to process the payment of compensation to persons in *ad hoc* cases. The decision to pay compensation – that is set up a scheme or arrangements to pay compensation is assumed to have been taken and the amount of compensation (which would be a transfer payment not a resource cost) is in principle the same in all options. But different options for operating the scheme will have different resource cost implications.

The operation of the scheme will have resource cost and benefit impacts on two distinct groups of persons: (a) the persons who are to receive compensation ("the beneficiaries") and (b) the persons responsible for the compensation (and who therefore set up the scheme and pay for its operation) ("the operators").

Clearly, the actual amount of costs and benefits would be affected by the scale of any actual scheme that was put in place i.e. by the numbers of people to whom compensation had to be paid. This cannot be estimated.

#### **(a) The beneficiaries**

There are two potential impacts on beneficiaries: reduced form-filling and less loss of interest.

##### *Reduced form-filling*

Unless the beneficiaries are a pre-determined and pre-identified group of people, they will have to make a claim to the paying agent and this will mean completing and submitting a claim form.

If a claim form is not required, the resource benefit to the beneficiaries is the same (i.e. £nil) whether the FSCS and another paying agent runs the scheme. If a claim form would normally be required, there will be a resource benefit to beneficiaries if the FSCS is able to run the special scheme as part of an existing claim process that it would have to run any way (and so dispense with a separate claim). This will be the case where the FSCS is acting as a single point of contact for a non-UK scheme or the UK Government in

cases where the it would also have to pay compensation in respect of the same matter to the same beneficiaries.

In all other cases, the beneficiary would simply be submitting a claim form to a different paying agent so there would be no resource benefit. Where relevant the value of the benefit per beneficiary is given by: Time taken to prepare and submit form x value of beneficiary's time. Time taken will probably be between 10 minutes and 1 hour. (This implicitly assumes that the time taken to find and pull together any supporting documentation etc will be the same in both options.) Assuming the beneficiaries' time is valued at £20 per hour, the benefit where relevant is between £3 and £20 per beneficiary.

#### *Less loss of interest*

Once a decision to set up a compensation scheme has been taken, there will be a resource benefit to the beneficiaries to the extent that the payment is paid more promptly in one option than in the other. Because the FSCS is an existing operational scheme, it is likely that it will be able to pay more promptly simply because less time will be needed to make the *ad hoc* scheme operational. FSCS may have to gear up to meet the demands of the *ad hoc* scheme but the organisation itself will not need to be created from scratch.

The size of this benefit will depend on the scale and novelty of the work required. Clearly it will be greatest where a relatively modest expansion of the FSCS is needed and the work fits well with the existing scheme. This will be the case where the FSCS is having to act as a single point of contact for a non-UK scheme (or for the UK Government) that would otherwise have to make the kind of compensation payments that the FSCS normally makes. On the other hand, the benefit would be considerably less if the FSCS was itself having to set up a large organisation to undertake essentially new work.

In any case, the benefit is given by: Reduction in delay in payment x interest rate x amount of compensation payable.

Assuming the reduction in delay is between 3 and 6 months, the interest rate is 2 per cent and the amount of compensation payable is £10,000, the benefit is between £50 and £100 per beneficiary.

Range of benefits (per beneficiary):

*Worst case* (no reduction in form filling, 3 month reduction in payment delay) - £50

*Best case* (1 hour reduction in form filling, 6 month reduction in payment delay) - £120

Sensitivities:

The estimate of benefit per person is probably most sensitive to the assumptions about payment delay, interest rates and amounts of compensation payable. These calculations overshadow the benefits from reductions in form filling.

The total benefit (both annually and as a present value) obviously depends upon the number of beneficiaries and the number of defaults a year. These cannot be estimated.

#### **(b) The operators**

Setting-up and running a compensation scheme obviously incurs administrative (i.e. resource) costs. (The compensation costs are transfers and will be the same in any option for running the scheme.) Administrative costs will depend on the size of the scheme (that is the number of beneficiaries) and on when it is used. The cost structure will depend on what is actually done. Setting up permanent arrangements (such as the FSCS already makes for its ongoing responsibilities) will incur set-up costs, fixed costs while the scheme is in place and variable costs when compensation is actually paid. Making special arrangements at the time of a specific need to pay compensation will mean costs are incurred at that time. Comparing permanent and special arrangements will always be difficult since it will be necessary to take a view on the number of occasions when they will be used, on the scale of operation on each such occasion and on the timing of each such occasion. Because of the likely importance of fixed costs, it is very difficult to make any estimate of the potential resource cost or benefit on a per beneficiary basis.

Whether there is a benefit or a cost to the operators of a scheme in an option will depend on whether the option reduces the administrative costs they would have to meet in paying compensation in the case concerned. A benefit is likely to arise if special arrangements could be made by the FSCS on an essentially marginal cost basis. This would probably be the case if the special arrangements required only a modest increase in the size of the FSCS and the new activity fitted with its existing responsibilities. In those circumstances, there could be a significant saving in fixed costs or one-off start-up costs in comparison with the costs of setting up a new organisation from scratch. Logically, if the FSCS was simply setting up a new organisation which would otherwise have had to be set up by another body, there is no reason to suppose there would be any costs or benefits.

Requiring the FSCS to put permanent arrangements in place to operate a single point of contact would generate resource benefits on the operator side if the cost of those arrangements was less than the cost of arrangements a foreign scheme had to make to pay compensation to UK beneficiaries. If, on the other hand, a foreign scheme already had functioning arrangements to deliver compensation in the UK, requiring the FSCS to make such arrangements would imply a resource cost. It is probably unlikely that such arrangements exist so a single point of contact should bring cost savings (as well as the benefits to beneficiaries discussed above).

It would be impossible to require the FSCS to put permanent arrangements in place to meet a possible future *ad hoc* requirement since there would be no basis for determining the scale or other requirements for such arrangements.

For the purpose of the impact assessment, it is assumed that:

1. There would be no saving in requiring the FSCS to make special arrangements that could not be linked to current activities. This gives:

*Worst case* - £nil benefit or cost

2. There would be savings (essentially in set-up and fixed costs) if the FSCS is able to carry out additional work using its the existing arrangements at largely marginal cost. This gives:

*Best case* - £50 per beneficiary.

These results are necessarily **very sensitive** to assumptions made about costs and the extent to which FSCS could take on additional work at marginal cost. Assumptions about numbers of claimants and fixed costs are critical.

## Conclusion

*Worst case* - £50 per beneficiary

*Best case* - £170 per beneficiary.

The total benefit will depend on the number of occasions on which *ad hoc* compensation schemes are required and the number of beneficiaries. But if we assume that on average there will be 1,000 beneficiaries a year and that the benefits are £110 per beneficiary (mid-point of the numbers above), the average annual benefit is £110,000 and the present value (discounted at 3.5% over ten years) would be £946,845. This is a purely illustrative number. Because of the importance of set-up and fixed costs, cost estimates are not scalable. If arrangements actually had to be made to compensate 1,000 people a year (or 10,000 once every 10 years), the actual costs could not be derived on a *pro rata* basis from estimates based on providing for paying compensation to a much larger number of claimants in a single year. Equally, special arrangements would not be made every year – permanent arrangements would have to be made.

## Specific impact tests

The FSCS is a statutory body. It does not operate on a commercial basis or in competition with private sector undertakings. The proposal would require it to act as paying agent for similar bodies in other countries or for Government. Neither the competition nor small firms tests are therefore relevant. There would be no impact on financial services firms in their capacity as FSCS levy payers.

The beneficiaries would normally be ordinary retail customers of financial services firms. These beneficiaries would therefore include individuals and small businesses. The benefits would accrue to all such customers probably in proportion to the size of their investments. There would be no disproportionate impact on persons of any race, gender or disability.

No other specific impact tests are relevant.

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	Yes	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	No	No
Rural Proofing	No	No

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HM Treasury</b>	<b>Title:</b> <b>Impact Assessment of allowing the cost of funding the exercise of SRR powers to be recovered from the FSCS</b>	
<b>Stage:</b> final proposal	<b>Version:</b> 1	<b>Date:</b> 1 November 2009
<b>Related Publications:</b> Banking Bill Impact assessment (October 2008) paragraphs 1.173 - 1.182		

**Available to view or download at:**

<http://www>.

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**Telephone:**

**What is the problem under consideration? Why is government intervention necessary?**

The costs of SRR powers can be recovered from the FSCS up to the net costs the FSCS would have incurred had the bank gone into default and FSCS compensation paid in the normal way. Both the actual SRR costs and the counterfactual FSCS costs would be spread over time and involve both inflows and outflows. But no allowance can currently be made for the interest costs or receipts that would arise because of these timing differences. So the true economic cost of an SRR cannot be recovered from the FSCS up to a cap based on the true economic cost to the FSCS in the counterfactual.

**What are the policy objectives and the intended effects?**

The policy objective (and intended effect) is to ensure that the true economic cost of the use of SRR powers can be recovered from the FSCS subject to a cap that would be consistently calculated from the true economic costs that the FSCS would have had to meet in the counterfactual.

**What policy options have been considered? Please justify any preferred option.**

There are only two options - "do nothing" and the preferred option. The preferred option will ensure that true economic costs of the SRR can be recovered from the FSCS up to a limit that reflects as accurately as possible the true economic costs that the FSCS would have incurred in the counterfactual - the scenario in which the bank defaulted and the FSCS paid compensation and made recoveries from the estate in the normal way.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** The policy will be reviewed as part of any review of the special resolution regime and Parts 1 - 3 of the Banking Act 2009.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups'
	One-off (Transition)      Yrs	
	£	
	Average Annual Cost (excluding one-off)	
£	<b>Total Cost (PV)</b>	£
Other <b>key non-monetised costs</b> by 'main affected groups' Cost of funding SRR costs transferred from the Exchequer to FSCS levy payers. This is a transfer and aggregate cost on both groups is zero. There will be a small additional resource cost arising from extra activity by an independent valuer; this cost will fall on the Exchequer.		

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	One-off      Yrs	
	£	
	Average Annual Benefit (excluding one-off)	
£	<b>Total Benefit (PV)</b>	£
Other <b>key non-monetised benefits</b> by 'main affected groups'		

Key Assumptions/Sensitivities/Risks
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Price Base Year	Time Period Years	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £
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What is the geographic coverage of the policy/option?	UK
On what date will the policy be implemented?	2009
Which organisation(s) will enforce the policy?	N/A
What is the total annual cost of enforcement for these organisations?	£
Does enforcement comply with Hampton principles?	N/A
Will implementation go beyond minimum EU requirements?	N/A
What is the value of the proposed offsetting measure per year?	£
What is the value of changes in greenhouse gas emissions?	£ Nil
Will the proposal have a significant impact on competition?	No
Annual cost (£-£) per organisation (excluding one-off)	Micro      Small      Medium      Large
Are any of these organisations exempt?	No      No      N/A      N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of    £	Decrease of    £	<b>Net Impact</b> £

Key:      Annual costs and benefits: Constant Prices      (Net) Present Value

## Evidence Base (for summary sheets)

The Banking Act 2009 introduced a special resolution regime (SRR) to provide for the more efficient resolution of failing banks and building societies. The SRR was used for the first time to resolve the Dunfermline Building Society at the end of March 2009. This measure will be applied from 19 November 2009 (the date of introduction of the Financial Services Bill) so as to ensure that the Exchequer can recover the opportunity cost of the funds it has contributed towards the cost of resolving the Dunfermline Building Society from the Financial Services Compensation Scheme (FSCS).

The SRR includes powers under which the Authorities can arrange for the transfer of the assets and liabilities of a failing institution, as well as shares and other securities issued by that institution to commercial purchasers, to a “bridge bank” owned by the Bank of England or into temporary public ownership. The SRR also allows for the payment of compensation to transferors and to third parties. Costs will also be incurred to make up the value of assets transferred to a person to whom any liabilities (e.g. customer deposits) have been transferred.

These costs would fall on the Authorities (to the extent they cannot be met from the assets of the failed bank). However, the Banking Act 2009 also amended the Financial Services and Markets Act 2000 (FSMA) to provide for the FSCS to contribute to the costs of the use of SRR powers. This is appropriate because, if the SRR was not used, the institution would have defaulted and the FSCS would have had to pay compensation to depositors in the institution in accordance with the rules. In those circumstances, the FSCS would also have taken over the depositors’ claims on the failed institution and made recoveries from the assets of the failed institution on its winding up. It is also appropriate, therefore, that the maximum amount the FSCS can be required to contribute is capped at the net cost that it would have incurred in this counterfactual scenario. The cap is set at the compensation the FSCS would otherwise have paid less the amount of the recoveries that it would have made from the winding up.

Unfortunately, the theoretical scheme just described (and which was implemented in FSMA and the FSMA (Contribution to Costs of Special Resolution Regime) Regulations 2009) did not take account of the time that both a bank resolution would take or that the winding up of a bank would take in the counterfactual scenario. In both scenarios, the Authorities and the FSCS would have to finance payments of compensation or resolution costs until these were reduced or eliminated by actual or hypothetical recoveries from the disposal of the assets of the failed bank and costs of financing would be incurred. These costs would be explicit if either the FSCS or the Treasury borrowed money specifically to finance the payments they made but there would always be an opportunity cost since, however the money paid was raised, the funds could always have been diverted to an alternative use. But FSMA does not allow the Treasury to recover the opportunity cost of funds used from the FSCS and it does not allow the cost of the funds that the FSCS would hypothetically have to raise in the counterfactual to be taken into account in setting the cap on the contribution the FSCS can be required to make to SRR costs.

The overall effect of this omission is that the contribution the FSCS can make to SRR costs is likely to be less than the net costs it would actually have incurred in paying compensation when an institution failed. However, the proportional extent of the shortfall would depend on the timing of recoveries and on differences in the patterns of recoveries in the SRR and in the counterfactual scenario. The amount of any shortfall would also depend on the size of the failing institution. However, based on estimates made in connection with some recent resolutions, the shortfall could range from between £½ billion to £3 billion. It is not possible to quantify this more precisely for the reasons just given.

The shortfall would mean the cost to the Exchequer of resolving failing institutions is higher than it otherwise would be. If the proposed reforms are enacted, this cost will be borne in the first instance by the FSCS and will be met ultimately by increased levies on the financial services industry. The proposal therefore implies a transfer from the FSCS levy payers to the Exchequer. But this is not a resource cost and accordingly there is no difference in resource costs between the “do nothing” and the preferred options.

However, there will be higher resource costs in the “preferred” option to the extent that more work is involved in estimating the limit on the FSCS contribution to SRR costs in the counterfactual scenario. Under the system introduced in the Banking Act, an independent valuer has to be appointed to estimate the amount of recoveries (dividends from the winding up) the FSCS would have made in the counterfactual scenario. In the preferred option, the valuer is likely to have to consider in more detail when the FSCS would have made recoveries so that the cost of funding can be calculated more accurately. (Recoveries are a financial inflow so they will reduce the amount of compensation or payments that has to be funded and hence, of course, the cost of that funding.) The preferred option

seems likely, therefore, to require more work by the independent valuer and this implies some additional resource costs. It is not possible to quantify these additional costs but it seems unlikely that they would be significant in comparison with the amounts of the shortfall discussed above, or as an addition to the costs already incurred in appointing a valuer.

The extra costs on FSCS levy payers will be divided among the levy payers in accordance with the appropriate FSCS rules (which are made by the FSA). In general, the effect of these rules is that levies are divided between institutions in proportion to the size of their deposit base. These additional costs will not fall disproportionately on small firms and are unlikely to affect competition between financial services firms. No other specific impact test is relevant.

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	Yes	No
Small Firms Impact Test	Yes	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

## Summary: Intervention & Options

<b>Department /Agency:</b>	<b>Title:</b> <b>Impact Assessment of Extension of FSA Information Gathering Powers</b>	
<b>Stage:</b> final proposal	<b>Version:</b> 2	<b>Date:</b> November 2009
<b>Related Publications:</b> 'Reforming financial markets'		

**Available to view or download at:**

<http://www.hm-treasury.gov.uk>

**Contact for enquiries:** John Sparrow

**Telephone:** 020 7270 5312

**What is the problem under consideration? Why is government intervention necessary?**

Unregulated entities may impose negative externalities on regulated firms that may threaten future financial stability through their financial activities. It is more efficient to require an unregulated entity, which tens or hundreds of regulated firms are dealing with, to provide the information directly than approaching the regulated firms in order to build up a (potentially incomplete) picture of the unregulated entity's potential systemic impact. The FSA requires a broadly drafted legal power to gather information from unregulated entities.

**What are the policy objectives and the intended effects?**

The FSA's existing information gathering powers are not sufficient in the light of its new financial stability objective. The threat to the stability of the financial systems of the UK may develop through the activities of business which are not regulated by the FSA, and do not come within the scope of its information gathering powers. The objective is to enable the FSA to identify future market failure and threats to financial stability that may originate outside the regulated boundary.

Intended effects: Enable the FSA to monitor and where necessary mitigate those threats.

**What policy options have been considered? Please justify any preferred option.**

Do nothing: may be possible to gather information on certain unregulated entities under existing powers. May result in an incomplete picture of the risks and would be more resource intensive.

Option 2: Expand the regulatory boundary to bring entities suspected of posing risks to financial stability into the boundary. May impose unnecessary costs on industry/stifle beneficial financial innovation and competition.

Preferred option: extend the FSA's information gathering power to enable the FSA to assess and take action on potential risks to financial stability in an efficient and proportionate way.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** The FSA publishes an annual report which includes details of its enforcement actions.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b>	<b>Description:</b>
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<b>COSTS</b>	<b>ANNUAL COSTS</b>	Description and scale of <b>key monetised costs</b> by 'main affected groups' There would only be a cost to unregulated entities currently outside of the scope of FSMA if the FSA exercised the new power. It is impossible to know which unregulated activity will in future become a threat to financial stability. It is therefore not possible to estimate market wide or even sector wide costs.		
	<b>One-off</b> (Transition) <b>Yrs</b>			
	£ N/A			
	<b>Average Annual Cost</b> (excluding one-off)			
	£ N/A		<b>Total Cost (PV)</b>	£
Other <b>key non-monetised costs</b> by 'main affected groups'				

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' It is not possible to quantify future market wide or even sector wide benefits accruing from the proposed extension to the FSA's information gathering powers.		
	<b>One-off</b> <b>Yrs</b>			
	£ N/A			
	<b>Average Annual Benefit</b> (excluding one-off)			
	£ N/A		<b>Total Benefit (PV)</b>	£
Other <b>key non-monetised benefits</b> by 'main affected groups'				

Key Assumptions/Sensitivities/Risks
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Price Base Year	Time Period Years	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	2010				
Which organisation(s) will enforce the policy?	FSA				
What is the total annual cost of enforcement for these organisations?	£				
Does enforcement comply with Hampton principles?	Yes				
Will implementation go beyond minimum EU requirements?	Yes				
What is the value of the proposed offsetting measure per year?	£ N/A				
What is the value of changes in greenhouse gas emissions?	£ N/A				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">Micro</td> <td style="width: 25%; text-align: center;">Small</td> <td style="width: 25%; text-align: center;">Medium</td> <td style="width: 25%; text-align: center;">Large</td> </tr> </table>	Micro	Small	Medium	Large
Micro	Small	Medium	Large		
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">No</td> <td style="width: 25%; text-align: center;">N/A</td> <td style="width: 25%; text-align: center;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)			(Increase - Decrease)
Increase of    £	Decrease of    £	<b>Net Impact</b>	£

Key:    Annual costs and benefits: Constant Prices    (Net) Present Value

## Evidence Base (for summary sheets)

### Issue

Unregulated entities may impose externalities on regulated firms that may threaten future financial stability through their financial activities. To assess the potential systemic impact of an unregulated entity, which tens or hundreds of regulated firms are dealing with, it is more efficient to require the unregulated entity to provide the information directly instead of attempting to build up a (potentially incomplete) picture by approaching the regulated firms individually.

### Policy Objectives

The objective is to enable the FSA to identify future market failure and threats to financial stability that may originate outside the regulated boundary – in order for the FSA to monitor and where necessary mitigate those threats. Although there are examples of current entities that may pose a threat to financial stability but which the FSA does not currently have sufficient power to gather information on, the nature of many future threats is currently unknown. Therefore the FSA requires a broadly drafted information gathering power to ensure future flexibility to respond to a constantly evolving profile of risks to financial stability.

Extending information gathering powers could also reduce the scope for regulatory arbitrage and, by ensuring a level playing field, enhance competition. FSA regulation of firms imposes costs on them and in turn on consumers using products or services they provide. Unregulated firms do not face these regulatory costs and may be able to charge less because of this. Where the underlying product or service is the same this kind of competition will be inefficient.

A final, more straightforward, rationale is the possibility of cost savings from gathering information directly from one firm. For example, if the FSA were concerned about the activities of an unregulated entity which tens or hundreds of regulated firms are dealing with, the FSA may be able to impose information requests or requirements on all of those firms in order to build up a (potentially incomplete) picture of the unregulated entity's overall position and its potential systemic impact. However, it may be more efficient both from the perspective of the regulated firms and also of the FSA to require the unregulated entity to provide the information directly.

### Options Considered

Option 1 - Do nothing: This leaves open the risk of threats to financial stability arising outside of the regulated sector and crystallising without timely intervention by the FSA. It may be possible to gather information on certain unregulated entities under existing powers, through, for example, counterparty surveys. However, this may result in an incomplete picture of the risks posed by the unregulated entity, and would be more resource intensive on the FSA and the regulated counterparties than requiring the information directly from the unregulated entity.

Option 2 - Expand the regulatory boundary: It would be possible to expand the regulatory boundary and directly bring any entities that are suspected of posing risks to financial stability into the boundary. Doing so without appropriate information is likely to impose unnecessary costs on the industry, or may stifle beneficial financial innovation and competition.

Option 3 - Extend the FSA's information gathering power: The **preferred option** would be to extend the FSA's information gathering power to allow it to gather information from unregulated entities. Having appropriate information gathering powers will enable the FSA to assess and take action on potential risks to financial stability in an efficient and proportionate manner, and to more accurately provide the Treasury with well informed advice about potential extensions to the regulatory perimeter. It may be more efficient both from the perspective of the regulated firms and also of the FSA to require the unregulated entity to provide the information directly.

## Discussion on Impact

The power is intended to be broadly defined to ensure future flexibility to respond to a constantly evolving profile of risks to financial stability.

Amending FSMA in order to provide the FSA with this power does not itself create a direct cost to firms. The FSA already has extensive information gathering powers under FSMA and therefore this extension will therefore not pose additional costs on regulated entities which are already covered by existing powers and duties.

This extension would only impose a cost to unregulated entities that are currently outside of the scope of FSMA but which may pose a threat to financial stability, if the FSA chose to exercise the power.

The purpose of the power is to assist with the identification of newly developing threats to financial stability. It is impossible to know which unregulated activity will in future become a threat to financial stability. It is therefore not possible to estimate market wide or even sector wide costs as the instances in which the power will be exercised are not yet known.

However, it is important to note that the FSA would not impose regular or ongoing information requests upon firms, but would use this power to make ad hoc requests where it considered that the activities of the entity or class in question would be likely to pose an actual or potential serious threat to financial stability in the UK.

The FSA would be required to give advance notification to any person on whom it proposes to impose an information requirement, and to take into account any representations made by or on behalf of that person in deciding whether to impose a requirement, and if so, what kind of requirement.

In determining the form and manner in which the information is to be provided, the FSA would be required to consider the costs to the entity in question of producing that information. Therefore, in considering a particular information request, the FSA would conduct a cost-benefit analysis to help it decide whether a request should be made of an entity or class of entities.

## Summary of Available Firm Cost Data

The FSA has firm level estimates of compliance costs for FSA rules, as contained in the Deloitte Cost of Regulation study<sup>35</sup>. This study generated rule-specific, ongoing per annum incremental cost estimates for the following three sectors: corporate finance; institutional fund management; and retail investment & pension advice.

The most relevant is the institutional fund management sector – the majority of the firms in the sample consisted of hedge funds, and this is one of the classes of entity that the FSA seeks to cover in the proposed extended information gathering power.

The report estimated the incremental cost of providing information and reports to the FSA for the institutional fund management sector was 0.027% of a firms total operating costs. This includes the cost of preparing and submitting quarterly/monthly and annual financial return and annual accounts to the FSA, which is 0.025% alone. We therefore use 0.027% as an upper bound and 0.01% (the cost of the other individual reporting rules) as a lower bound.

While Deloitte did not convert these percentage of total operating cost estimates into financial figures, it is possible to do so, subject to two important caveats. Firstly, the low sample sizes used cannot be assumed to be representative of the wider population of firms; and secondly there was limited challenge of the judgments made by firms about incremental costs.

Bearing these shortcomings in mind, the incremental costs of providing information and reports to the FSA for firms in the institutional fund management sector is approximately £550.60 per firm per annum. Using the upper bound, the cost would be £14,866.20 per firm per annum. Further details can be found in the Annex.

Combining these estimates with the global population of 5,350 distinct fund management companies, suggests that for the institutional fund management sector, the industry-wide incremental cost of providing information and reports to the FSA is £2.95 million, with a maximum upper bound estimate of £79.5 million.

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<sup>35</sup> The final report can be found here:  
<http://www.fsa.gov.uk/pages/About/Media/notes/bn022.shtml>

## Specific Impact Tests: Checklist

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

## Summary: Intervention & Options

<b>Department /Agency:</b> <b>HMT</b>	<b>Title:</b> <b>Impact Assessment of giving HMT powers to request information directly from participants in the Asset Protection Scheme</b>	
<b>Stage:</b> final proposal	<b>Version:</b> 2	<b>Date:</b> November 09
<b>Related Publications:</b>		

Available to view or download at:

**Contact for enquiries:** Stefanie Rupp

**Telephone:** 02072706251

### What is the problem under consideration? Why is government intervention necessary?

HMT does not have its own legal powers to collect information from financial institutions participating or proposing to participate in the Asset Protection Scheme. It needs the information to effectively operate the scheme and assess the risk to the taxpayer. Statutory powers are required to avoid giving potential rise to legal claims of breaching confidentiality obligations that the participating banks owe to their counterparties.

Only legislation will allow HMT to require information directly from the participating banks in relation to the Asset Protection Scheme.

### What are the policy objectives and the intended effects?

To support the Treasury's objective of financial stability, the Treasury has to be able to manage the Asset Protection Scheme effectively. To achieve this, the Treasury needs detailed information on the assets in the scheme. The power to require information will provide certainty that the Treasury can get the information it needs, and will also provide APS participants with legal certainty that they are under a legal obligation to provide APS-related information to HMT.

### What policy options have been considered? Please justify any preferred option.

- Rely on the FSA to use Part 11 FSMA powers expanded through the Banking Act 2009 to provide HMT with the required information
- Use Bank of England powers to request information for HMT - concluded that not feasible
- Legislate for HMT to be able to require information in relation to operating the Asset Protection Scheme directly. This would provide legal certainty for the course of the Scheme and would enable a more secure, cheaper and faster transfer of data, beneficial to the efficient operation of the Scheme and minimising the risk to the taxpayer and the banks.

### When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

The Asset Protection Agency, a HMT executive agency, charged with the day to day operation of the APS, will produce annual accounts with information on operating the scheme, inc data transfer.

### **Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b> HMT powers	<b>Description:</b> Legislate to enable HMT to request information related to the Asset Protection Scheme directly from participating banks
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<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' N/A	
	<b>One-off</b> (Transition)	<b>Yrs</b>		
	£ 0			
	<b>Average Annual Cost</b> (excluding one-off)			
	£ 0		<b>Total Cost (PV)</b>	£ 0
Other <b>key non-monetised costs</b> by 'main affected groups' N/A				

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' N/A	
	<b>One-off</b>	<b>Yrs</b>		
	£ 0			
	<b>Average Annual Benefit</b> (excluding one-off)			
	£ 0		<b>Total Benefit (PV)</b>	£ 0
Other <b>key non-monetised benefits</b> by 'main affected groups' This policy will allow the Treasury to monitor the APS more effectively by receiving data more quickly and in a direct, secure way. There may be a negligible cost saving for the participants in the APS when transferring data related to the Scheme directly to HMT and not via third parties.				

<b>Key Assumptions/Sensitivities/Risks</b> Note that we expect to recharge all running costs in relation to the Asset Protection Scheme to the participating banks.
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Price Base Year	Time Period Years	<b>Net Benefit Range</b> (NPV) £ 0	<b>NET BENEFIT</b> (NPV Best estimate) £ 0
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What is the geographic coverage of the policy/option?				UK
On what date will the policy be implemented?				Royal Assent
Which organisation(s) will enforce the policy?				HMT
What is the total annual cost of enforcement for these organisations?				£ 0
Does enforcement comply with Hampton principles?				Yes
Will implementation go beyond minimum EU requirements?				N/A
What is the value of the proposed offsetting measure per year?				£ 0
What is the value of changes in greenhouse gas emissions?				£ 0
Will the proposal have a significant impact on competition?				No
Annual cost (£-£) per organisation (excluding one-off)	0	0	0	0
Are any of these organisations exempt?	Yes/No	Yes/No	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of	£ 0	<b>Net Impact</b> £ 0
Decrease of	£ 0	

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

### The Asset Protection Scheme - policy background

1. On February 26th 2009, the Government announced details of the Asset Protection Scheme (“APS” or “the Scheme”). The high level objective of the APS is to provide participating banks with a Treasury guarantee in respect of losses which arise from the banks’ assets which are covered by the scheme. Working in a similar manner to an insurance policy, participants pay HMT a premium, in return for which HMT pays for losses over and above agreed thresholds.
2. On November 3<sup>rd</sup> 2009, the Government announced the conclusion of discussions with Lloyds Banking Group and Royal Bank of Scotland (RBS) regarding their participation in the Government’s Asset Protection Scheme. As a result of improved economic conditions and following extensive due diligence announced in February, the Government has announced that Lloyds will not participate in the APS and instead will raise additional private sector capital and pay a fee to the taxpayer for the implicit protection provided to date. This will reduce the risk borne by the taxpayer, improving value for money. RBS will participate in the APS under revised terms that improve incentives and deliver better risk-sharing with the private sector.
3. Under the APS, banks which are permitted to accede to the scheme can cover their eligible assets with the Government’s APS guarantee. Once a ‘first loss’ borne by the participant has been exceeded, losses on covered assets will be recoverable from HMT and the bank will receive a payment from HMT in due course. The APS aims to remove continuing uncertainty about the value of banks’ past investments, cleaning up banks’ balance sheets and providing them with greater confidence to rebuild and restructure their operations and increase lending in the economy. Ultimately, the objective of the APS is to further enhance financial stability and support increased lending to homeowners and businesses.

### Issue

4. In order to operate the Scheme effectively, HMT must have access to considerable volumes of bank data, on a regular basis, on the assets covered by the APS. In particular, HMT requires some of the data to name the parties with whom the banks have transacted.
5. For retail assets, HMT has decided not to request the identity of the obligor, as the other information on the asset is deemed sufficient. Any benefit of having such information is outweighed by the risks associated with HMT holding volumes of personal data.
6. Whilst anonymised data is acceptable to HMT for retail assets, this is not the case in relation to commercial assets. In particular, whilst it is possible satisfactorily to assess the likely performance of retail/SME assets on an anonymised portfolio basis, this approach is much less satisfactory in relation to larger, corporate assets.
7. For non-retail assets HMT is requesting disclosure by the banks participating in the APS of data which will identify counterparties of the participating banks. This is to ensure that the APS is able to effectively operate throughout its life, to monitor the compliance by participating banks with the APS terms and conditions on an ongoing basis, and to project the likely costs to the taxpayer.

### *Confidentiality provisions*

8. This requirement for “named” asset information is a concern for the participating banks because of the duty of confidentiality that they owe to their customers, whether express or implied.
9. Where information is subject to duties of confidentiality, the banks are concerned that disclosure of non-anonymised data may breach these duties and give rise to civil claims. HMT also wish to avoid a situation where encouraging the banks to accept the relevant data disclosure terms under the APS could be viewed as HMT procuring a breach of confidentiality by the banks, even if this risk is a small one.
10. Another concern raised by the banks was that the existence of duties of confidence owed by the banks to other parties might generate applications by those parties for injunctions to prevent disclosure of confidential information to HMT. This could lead to a situation where the banks would become unwilling to disclose further information. Without the information, it might be very difficult for HMT to operate the Scheme effectively.

## Statutory powers

11. The objective of the statutory power is to override the confidentiality agreements participants typically have with their counterparties. However, HMT currently has no statutory power to require financial institutions to supply information directly to it. Since the creation of the FSA as the financial services regulator, the Treasury is reliant on information being passed to it by either the FSA or the Bank of England. Below is a summary of the information gathering powers the FSA and Bank of England already have.

## FSA information gathering powers

12. The FSA's principal powers to obtain information are contained in Part 11 of FSMA and particularly Section 165. That section gives the FSA the power to require the production of specified information or documents by persons authorised under FSMA.
13. The FSA's information gathering powers in FSMA have been expanded by the Banking Act 2009. Section 250 of that Act provides that the FSA shall collect information that it thinks is or may be relevant to the stability of (a) individual financial institutions, or (b) one or more aspects of the financial systems of the UK. Currently, the FSA's powers in section 165 of FSMA are interpreted in accordance with sections 249 and 250 of the Banking Act 2009, and the Treasury receives the required data via the FSA pursuant to a statutory gateway under the FSMA Disclosure of Confidential Information (Regulations 2001 SI2001/2188).
14. The data transfer process via the FSA has worked reasonably well in the short term, but
  - a. It makes data transfer from the participant to the FSA to the Treasury more complicated and less secure
  - b. It could give rise to longer term legal uncertainty as to whether the Treasury can continue to obtain the information it requires for the effective operation of the APS, depending on the interpretation of the Banking Act 2009.

## Bank of England information gathering powers

15. The Bank's powers to obtain information are primarily contained in Section 17 of the Bank of England Act 1998. The Bank's powers to disclose information which it obtains are contained in Section 37 and Schedule 7 of the 1998 Act. As applies to the FSA, the Bank may not generally disclose such information other than with the consent of the person providing the information or the person to whom it relates. Schedule 7 provides exceptions to this general restriction, including that disclosures may be made to the Treasury to enable or assist the Treasury to discharge any of the Treasury's functions under FSMA. HMT have taken the view that the information sought from the banks participating in the APS in this context would not be information aimed at enabling or assisting HMT to discharge its FSMA functions, which are limited.
16. In addition, the Bank of England Act 1946 contains powers in Section 4. That provision allows the Bank to request information from and make recommendations to "bankers" where it is necessary to do so in the public interest and with HMT's authorisation, can issue directions to ensure that effect is given to such requests/recommendations. However section 4 has not been used previously.

## Options

17. The Treasury has been focussed on identifying an appropriate legal or regulatory requirement, which could give the participating banks the comfort they seek to disclose all APS-related information to HMT. The Treasury has adopted an interim solution whereby the FSA collects the data from the banks using its powers under Section 250 of the Banking Act 2009 and Section 165 of the Financial Services & Markets Act 2000 ("FSMA"). The FSA then sends a copy of the data to HMT. It relies on the FSA satisfying itself, as it has done, that the information relates to the stability of the financial institution or to one or more aspects of the financial system of the UK (as required by Section 250 Banking Act 2009).

18. The banks also appear satisfied that this solution provides comfort to provide data to HMT. However, the solution is problematic long term for three principal reasons:

- There are practical issues surrounding the provision of data to the FSA and FSA then copying it to HMT in a secure, fast way. Having an additional layer between the banks and HMT in the form of the FSA necessitates additional processes, which have to be completed each time, which increase the risk of data provision being delayed.
- The current solution relies upon the FSA continuing to regard the collection of such data as being within their Banking Act 2009 remits. There is a risk that, as the APS beds in and the economy recovers, the FSA might take the view that the data does not relate to the stability of the financial institution or to one or more aspects of the financial system of the UK. That would leave HMT without a means of obtaining the data from the banks.
- Whilst the requirement to provide the data to the FSA pursuant to an FSA notice currently satisfies the banks, the banks are of the view that there is still a risk, albeit low, for a dispute between the banks and third party obligors as to whether the FSA requirement exempts them from their contractual confidentiality restrictions.

19. For these reasons, we have considered whether there is a more appropriate longer-term solution to the problem of the banks' confidentiality restrictions.

20. HMT's view is that the only solution which would provide a) legal certainty for the banks, their counterparties and HMT and b) a direct route for the provision of data between the banks and HMT, is to put in place a statutory requirement in primary legislation which requires APS participants to provide any data which may be required by HMT under the terms of the APS contracts.

21. The proposed measure constitutes a relatively simple, definitive and proportionate solution to this problem, which might otherwise seriously impede HMT's ability to properly assess its risks in relation to the APS covered assets. The objective of the proposed power is to provide the participating banks with a clear legal requirement to provide APS information to HMT, which would override their third party confidentiality obligations. Direct provision to HMT is also more efficient.

## **Costs and benefits**

22. Under the APS agreement, participating banks have already committed to supply information the Treasury requires in order to enable the effective operation and monitoring of the scheme. Therefore, this legal measure in itself does not impose any additional requirements and thus costs on the participating banks or on the Treasury.

23. Instead, the benefit of this statutory power is long-term legal certainty and a direct route for data provision enabling a more secure and potentially faster and more efficient transfer, which is non-monetary in nature.

24. There may be some very small monetary benefits from transferring data directly from the participants to the Treasury and not via the FSA, due to

- Lower courier costs in the shorter term whilst data is transferred via DVDs using courier services
- No need to synchronise IT systems with the FSA in the longer term
- No FSA staff effort required in data transfer.

25. We have not identified any other significant impacts.

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	No	No
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	No
Disability Equality	No	No
Gender Equality	No	No
Human Rights	No	No
Rural Proofing	No	No

## Summary: Intervention & Options

<b>Department /Agency: National Savings &amp; Investments</b>	<b>Title: Impact Assessment of extending Director of Savings remit to undertake on work on behalf of MOJ (Accountant General)</b>	
<b>Stage:</b> final proposal	<b>Version:</b> 2	<b>Date:</b> November 2009
<b>Related Publications:</b>		

**Available to view or download at:**

<http://www.hm-treasury.gov.uk>

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**What is the problem under consideration? Why is government intervention necessary?**

Administration of funds in court is carried out by the Court Funds Office (CFO) on behalf of the Accountant General. Modernisation of the service is necessary to continue to meet the AG's responsibility for protecting the affairs of the legally vulnerable and to offer the best service possible. Transfer to NS&I, a proven provider of financial services, is CFO's preferred option.

Although simply a transfer of administrative functions the Director of Savings role is as prescribed in statute. She does not have the power to take on the CFO work without a remit extension via primary legislation.

**What are the policy objectives and the intended effects?**

The aim of the legislative change is twofold:

1. allow the Director of Savings to accept the CFO work; and then
2. to extend the 1998 NS&I Contracting Out Order so that this new function may also be undertaken by Siemens Information Systems as part of the outsourced work package which Siemens already carry out under their contract with NS&I.

**What policy options have been considered? Please justify any preferred option.**

Options considered by CFO were :

1. Internal CFO transformation with new in-house IT.
2. Transfer out of IT and administration support functions to the private sector;
3. Transfer IT and operations to the private sector;
4. Transfer of IT and operations elsewhere within government (NS&I).

Transfer to NS&I was shown to be the most cost effective option - saving some £4million per annum (35% saving) against current running costs; and £1million per annum against the private sector.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** Actual costs and benefits will be tracked on an ongoing basis as an integral part of the transfer arrangements between CFO and NS&I.

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

*I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.*

Signed by the responsible Minister:



.....Date: 17 November 2009

## Summary: Analysis & Evidence

<b>Policy Option:</b> NS&I Clause	<b>Description:</b> extending Director of Savings remit to undertake on work on behalf of MOJ (Accountant General)
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C O S T S	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' one-off costs - NS&I set-up and management fees (~35%), CFO staff costs (~30%), IT data migration and technology costs (~14%), provision for staff redeployment costs (~10%). Average annual costs represent residual MoJ staff costs (~7%), NS&I annual running fees (~65%), court recharges (~17%), ongoing enhancement costs (~7%)
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	<b>£ 15.8m</b>	4	
	<b>Average Annual Cost</b> (excluding one-off)		
	<b>£ 8.5m</b>	<b>Total Cost (PV)</b>	<b>£ 61.5m</b>
<p><b>Other key non-monetised costs</b> by 'main affected groups'</p> <p>Risk of MoJ reputational damage and associated costs if modernisation programme is significantly delayed with possible disruption to existing arrangements.</p>			

B E N E F I T S	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups'
	<b>One-off</b>	<b>Yrs</b>	
	<b>£ 29.2 m</b>	0	
	<b>Average Annual Benefit</b> (excluding one-off)		
	<b>£ 4 m</b>	<b>Total Benefit (PV)</b>	<b>£ 93.3 m</b>
<p><b>Other key non-monetised benefits</b> by 'main affected groups'</p> <p>Improved customer and stakeholder satisfaction plus achieving a clearer strategic fit for CFO operations within government. Responsibility for protecting the financial affairs of the vulnerable remains within Government.</p>			

**Key Assumptions/Sensitivities/Risks**  
 Numbers exclude VAT and inflation. NPV at discount rate of 3.5%. NS&I service goes live from autumn 2011. Key risk is NS&I legislative timetable.

Price Base Year 0	Time Period Years 0	<b>Net Benefit Range</b> (NPV) £	<b>NET BENEFIT</b> (NPV Best estimate) <b>£ 31.8 m</b>
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What is the geographic coverage of the policy/option?	England and Wales			
On what date will the policy be implemented?	Summer 2010			
Which organisation(s) will enforce the policy?	NS&I			
What is the total annual cost of enforcement for these organisations?	£ 0			
Does enforcement comply with Hampton principles?	Yes			
Will implementation go beyond minimum EU requirements?	No			
What is the value of the proposed offsetting measure per year?	£ 0			
What is the value of changes in greenhouse gas emissions?	£ 0			
Will the proposal have a significant impact on competition?	No			
Annual cost (£-£) per organisation (excluding one-off)	Micro	Small	Medium	Large
Are any of these organisations exempt?	Yes	Yes	N/A	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)	
Increase of	£ 0	Decrease of	£ 4 m
		<b>Net Impact</b>	<b>£ -4m</b>

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

The CFO provides investment and banking administration services for clients whose money is held under the control of the civil courts of England and Wales, including the Court of Protection (CoP). It accounts for monies paid into and out of court and acts as custodian for any investments made with that money. CFO provides this service for around 150,000 clients with a total of £4.6bn. In this way the CFO discharges the statutory responsibilities of the Accountant General of the Senior Courts (previously known as the Supreme Court) to safeguard client funds.

Modernising the administration of funds in court is necessary in order to continue to meet the Accountant General's responsibility for protecting the financial affairs of the legally vulnerable and to offer the best service possible to CFO's clients.

The financial services focus of CFO is unique within the MoJ and the work is not core to the primary responsibilities of MoJ. Modernisation alone does not address this problem. MoJ would continue to provide services that are not its core business and for which it requires specialist skills and IT. Finding a suitable partner allows MoJ to modernise using the experience of those who specialise in such financial services work while continuing to provide this service from within Government.

### Options evaluation approach

The evaluation methods used in the appraisal of the following options sections are compliant with the Treasury Green Book.

Option	Title	Description
1	Internal modernisation	Internal business transformation programme supported by commercial off-the-shelf (COTS) products and an appropriate systems integrator
2	Funds administration outsourcing	External partner for administration only; customer service retained within Government
3	Funds administration and customer service outsourcing	External partner for administration and customer service
4	Transfer of operations to NS&I	Administration and customer service provided through existing NS&I operations

Benefits have been assessed using proven benefits mapping techniques, weighting and scoring. Net Present Values from the costs of these four options were compared to a 'Do Nothing' baseline.

MOJ officials and ministers have agreed the full CFO Business Case for Change. Treasury Ministers have also agreed the principle that NS&I should undertake this work on behalf of the Accountant General which is in line with the 2004 Gershon efficiency review recommendations. Gershon specifically identified such standardisation of transactional services across government as a prime area for efficiency gain.

Only the costings related to the NS&I option (i.e. Option 4) for which legislation is required are included in this impact assessment.

## Specific Impact Tests: Checklist

<b>Type of testing undertaken</b>	<b><i>Results in Evidence Base?</i></b>	<b><i>Results annexed?</i></b>
Competition Assessment	Yes	Yes
Small Firms Impact Test	No	No
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	Yes	No
Disability Equality	Yes	No
Gender Equality	Yes	No
Human Rights	Yes	No
Rural Proofing	No	No

### **Competition Assessment**

1. The impact of this work from an EU procurement legislation perspective has been examined by legal advisers from both MOJ/CFO and NS&I. They have taken into account the nature of the work, the original NS&I OJEU notice and current OJEU procurement rules. The advice received has concluded that NS&I undertaking this work should be non contentious from an OJEU procurement perspective.
2. Challenge for any OJEU procurement (not just this contract) where work is being added to an existing contract is normally related to three main issues - a) is the work within the scope of the original OJEU notice, b) does the notice cover the contracting entity requesting the work and c) materiality - does the volume of the work substantially change the size (and, by implication, the commercial attractiveness to the market) of the original contract.
3. With regard to the first issue, both internal analysis and external legal advice has concluded that the work is well within scope of the original OJEU notice and the current contract. The notice advertised for services in a wide sense, including 'process handling and information technology' and 'provision of general support functions'. The work will be undertaken on NS&I infrastructure using the same skills and technology, in the same location as NS&I work and involves extremely similar processing types such as deposits, repayments and change of details. The CFO functions largely mirror the nature of NS&I's current work, which is outsourced to Siemens and on this basis it is believed that the work is comfortably in scope.
4. The work undertaken will be work that NS&I will be permitted to undertake by statute and the contract for services will be between NS&I and Siemens (with a corresponding inter governmental agreement with NS&I and the CFO). It is therefore considered that the OJEU notice covers the contracting entity requesting the work.
5. In terms of volume, the CFO work - at only 1% of NS&I volumes - is not sufficiently material to change the nature of NS&I's existing contract with Siemens. Addition of this work is, therefore, considered unlikely to be challenged.
6. Lastly the Siemens contract expires in 2014 and a new procurement exercise, for a combined NS&I/CFO service, will need to be initiated at about the same time as NS&I plan to take on the CFO work. There would be little incentive for anyone to mount a challenge.

### HM Treasury contacts

This document can be found in full on our website at:  
[hm-treasury.gov.uk](http://hm-treasury.gov.uk)

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