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**IMPACT ASSESSMENT GUIDELINES**

**FOR EU LAMFALUSSY LEVEL 3 COMMITTEES**

**FEEDBACK STATEMENT**

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## Introduction

1. On 24 May 2007 CESR, CEBS and CEIOPS published a joint consultation paper on draft Impact Assessment ("IA" hereafter) Guidelines to be used by the three Lamfalussy Level 3 Committees. The closing date for consultation responses was 24 August 2007. The guidelines are designed to provide the Committees' Expert Groups with a practical tool to assist them when using IA as part of their policy analysis and in the course of formulating recommendations.
2. The three Level 3 Committees' commitment to develop an IA methodology for their own use reflects agreement taken by the European Institutions in December 2003 to incorporate the principles of better regulation into their legislative practices and procedures. In addition, the White Paper on Financial Services published at the beginning of 2006 (Annex 2 COM(2005)629 of 05/12/2005), mentions explicitly that IA will accompany any new Commission proposal. Thus, the adoption by the three Level 3 Committees of their own IA guidelines keeps them in step with approved EU practice.
3. This feedback statement will discuss the main points that were made by respondents during the consultation process, and describe how we have taken account of them in revising the guidelines. We will also briefly consider the lessons learnt from the pilot studies conducted by CESR and CEBS.
4. The feedback statement does not give a line-by-line description of all the drafting changes made as these are too numerous to include here. Nor does it address a number of comments received from respondents which it was felt on balance should not be taken into account, either because they were neither in line with our thinking nor with the views expressed by the majority of respondents, because they addressed issues beyond the scope of the guidelines, or because they raised issues that we judged were already dealt with adequately in the guidelines.
5. Over a dozen responses were received in response to the consultation. These came from a variety of industry associations including representatives of the banking, securities, insurance and pensions industries. Securities dealers and exchanges were particularly well represented. All public responses can be viewed on the three Committees' websites.
6. Section 2 of this feedback statement will focus first on the substantive points which were raised by respondents, before briefly considering a combination of subsidiary points, and answers to the four questions posed in the consultation paper. Section 3 of the feedback



statement will briefly describe the CESR and CEBS pilot studies and highlight the main lessons learnt.



## Consultation feedback

7. Respondents to the consultation welcomed the L3 Committees' commitment to introduce IA into their working practices. It was seen as an essential contribution to the better regulation agenda and an important aid to better policy making. In particular, the use of Market Failure Analysis (MFA) and Regulatory Failure Analysis (RFA) to ensure that regulatory intervention is pursued only when clearly shown to be necessary and proportionate was fully endorsed.
8. The L3 Committees are committed to integrating the use of IA into their policy making processes. We intend to use MFA/RFA to make the case for our discretionary initiatives and to help us frame advice to the Commission, and we look forward to working cooperatively with all stakeholders to ensure that the initiative is a success.

### Key Issues

9. The following issues, which are dealt with in turn below, were particularly prominent in the majority of consultation responses:

#### Governance and quality control

10. Governance and quality control issues were highlighted by many respondents. The case was made for the conduct of IA to be placed, where possible, in the hands of independent experts, to be subject to independent scrutiny and challenge by a panel of IA experts and/or senior decision makers and for senior management sponsorship of the IA process to be embedded in the working practices of the L3 Committees. It was suggested that an explanation should be made in situations in which the results of an IA exercise have been ignored.
11. The L3 Committees recognise the importance of having effective governance and quality control arrangements in place in order to ensure that IA exercises make a genuine contribution to the policy making process. The Committees consider that the soundness and independence of IA exercises will be safeguarded by (a) the involvement of IA experts from within the L3 Committees but who are independent of the Committees' relevant policy making expert groups, (b) the various panels of stakeholder groups that assist the L3 Committees, and which are always invited to comment during the policy-making process, and finally (c) the process of public consultation. Together, these three elements should ensure that policy makers and the senior management of the L3 Committees, by being held



accountable for the quality of IA exercises, are appropriately incentivised. The incentive to guarantee high quality IA is of course further enhanced where the IA contributes to L2 committee calls for advice.

#### Treatment of MFA

12. Several respondents raised specific concerns about the references to MFA in the guidelines. Whilst approving of the use of MFA, respondents suggested that some of the concepts involved could be more clearly or accurately expressed (eg the definition of information asymmetry). More generally, concerns were voiced about how the L3 Committees would use MFA in deciding whether or not to pursue a particular initiative. The point was made that the burden of proof should be on the regulatory authorities to justify interventions and not on the regulated community to justify non-intervention.
13. The guidelines have been amended in a number of places in order to improve the way in which MFA is described. In relation to the way in which the MFA test will be applied, we believe that the guidelines accurately set out the fact that intervention is only justified on MFA grounds if there is a significant market failure, no prospect of a market-based solution in the near term, and a reasonable prospect that intervention will yield net benefits. So in this respect we believe that the burden of proof is indeed on the regulatory authorities to justify regulatory interventions.
14. The question of significance in this context is controversial but we believe most appropriately left to the judgement of policy makers. In this context, the main role for stakeholders is to provide policy makers with information that will make such judgements easier to reach. It was suggested that a quantitative standard could be applied to judge significance, but we believe that this displaces the need for judgement rather than removing it.

#### Timing of stakeholder involvement

15. Respondents highlighted the importance of involving industry and other stakeholders throughout the impact assessment process, for example in relation to decisions about the type of IA exercise to be conducted (e.g. screening or full IA), and of ensuring that the right balance is struck between the need for IA and prompt response to L2 Committee calls for advice (particularly given the fact that timing constraints often bite). It was suggested that the guidelines did not give due weight to the importance of informal consultation with stakeholders throughout the impact assessment process.



16. The L3 Committees recognise the importance of involving stakeholders in the policy making and IA process and will continue to do so, both formally and informally. The guidelines have been revised accordingly. The time available to the L3 Committees in which to respond to L2 Committee calls for advice, for example, is not necessarily within the control of the L3 Committees, but the importance of establishing and clarifying timelines and ensuring that IA exercises are designed to take account of time constraints is recognised. The L3 Committees believe that the guidelines provide the necessary flexibility to ensure that stakeholders are involved in an appropriate manner at all times.

17. In relation to the suggestion that stakeholders should be involved in the process of determining the scope of an IA exercise (ie screening versus full IA) we believe again that the guidelines provide the necessary degree of flexibility to ensure that stakeholder inputs can be incorporated into such processes as policy makers deem appropriate.

#### Competition and competitiveness

18. Respondents voiced concerns about the extent to which the guidelines addressed issues of competition and competitiveness. In particular, the L3 Committees were urged to ensure that IA exercises should take account of the impact of policy proposals both on competition and on the competitiveness of the EU financial services industry.

19. The guidelines have been revised to take account of these concerns. The L3 Committees recognise that such impacts should, when appropriate, be considered as part of the IA process.

#### Other Comments

20. A number of respondents stressed the need for the L3 Committees to justify a decision not based on the outcome of an IA exercise. The guidelines have been modified to confirm that this should indeed be the case.

21. It was suggested that it was simplistic, particularly in relation to prudential regulation, to assume that costs imposed on firms would be automatically passed on to consumers. The guidelines acknowledge that the extent to which, and the speed with which, costs may be passed on to consumers is an important issue to consider.

22. Concern was voiced about whether or not quantitative assessment would form part of the ex-post review of regulatory initiatives and the extent to which stakeholders would be involved in the process. In fact, the guidelines state that in an ex-post review “the IA



methodology should be applied in just the same way”, which will of course include the use of quantitative assessment and the same sort of dialogue with stakeholders that would be expected as part of a standard IA exercise.

23. Some respondents raised the issue of tractability, in other words, the practical difficulties that can be encountered by policy makers and stakeholders alike when, for example, seeking to pursue technical data gathering exercises or employing quantitative analysis techniques.
24. The L3 Committees recognise these difficulties and the guidelines have been revised to acknowledge this reality. The guidelines also highlight the fact that IA exercises need to be proportionate to the issue under consideration. Nevertheless, the L3 Committees accept that there will be occasions in which it will be appropriate to pursue technically difficult forms of impact assessment. In such circumstances, there may, for example, be a need for the L3 Committees to liaise with the L2 Committees (should the exercise in question be driven by a L2 Committee call for advice) in order to consider whether additional time or the provision of specific resourcing may be required in order to conduct the analysis.
25. A number of respondents suggested that the use of the term “direct costs” to refer to the costs borne by regulatory bodies was misleading. The guidelines have been revised and instead refer to “regulator’s costs”.
26. Specific concerns were raised about the definition of compliance costs in relation to establishing the baseline against which the impact of policy proposals should be assessed. The concern was voiced that the baseline would be established in relation to “best practice” in an industry, which could in theory measure costs that are in fact greater than those implied by existing legal requirements. The guidelines have been amended to confirm that in the normal course of events the costs of any policy proposal should be considered in terms of those additional costs that would be borne by a “typical” or “normal” market participant. Policy makers would, of course, be expected to take account of the realities of a particular market place in making such a judgement.
27. Finally, it was suggested that IA exercises should also take account of legal implications, for example in relation to the interplay between different regulatory initiatives. The IA guidelines are designed primarily to address the economic consequences of policy initiatives only and do not address legal issues explicitly for that reason. Nevertheless, we recognise that legal issues may in some circumstances warrant consideration in the context of an IA exercise.

## Questions





***Question 1: Do you think the proposed IA guidelines cover all key aspects of an impact assessment exercise?***

28. Consultation respondents broadly agreed that the IA guidelines cover all key aspects of an IA exercise. Respondents recommended a number of amendments to improve the way in which some of the steps in an IA are presented in the guidelines, and many of these suggestions have been taken into account during the process of amending the guidelines. These include comments on the treatment of benefits, costs and international competitiveness.

***Question 2: Do you think market failure analysis (MFA) and regulatory/supervisory failure analysis (RFA) are given due consideration in the IA guidelines?***

29. Respondents supported the decision to include MFA/RFA in the IA guidelines and indicated that they thought it was given due consideration. Some respondents suggested amendments to the way in which MFA/RFA is treated in the guidelines because of concerns that certain definitions were not as clear as they could be and because of fears that the MFA test would be used inappropriately.

30. Due account has been made in the revised guidelines of the comments made in relation to the treatment of MFA/RFA.

***Question 3: Does the consultation process in the IA guidelines (publication of the draft policy accompanied by the IA analysis, publication of responses received and feedback statement) cover all key aspects of consultation?***

31. Respondents broadly endorsed the consultation process outlined in the IA guidelines. It was suggested that various aspects of the consultation process should be clarified, particularly in relation to the timing of formal and informal consultation exercises. More generally, the point was made that industry should be involved in all major stages of the IA process.

32. We have revised the guidelines taking into account the various comments made in relation to the way in which the L3 Committees consult with stakeholders.

***Question 4: Do you think that the proposed IA guidelines are sufficiently practical to enable policy makers to conduct IA effectively?***

33. Respondents to the consultation generally felt that the IA guidelines were sufficiently practical, though as one respondent pointed out, only time will tell. Some respondents raised concerns about the readability of the guidelines. Accordingly, drafting changes have been made to improve the overall quality of the text and to address specific issues raised by



respondents, including in relation to data gathering and the handling and presentation of confidential information provided by firms.

## Testing via pilot studies

34. The press release dated 24 May 2007 accompanying the publication of the draft L3 IA guidelines confirmed the intention of the L3 Committees to test the effectiveness of the IA guidelines via pilot studies. CESR has tested the guidelines in the process of its review of the Simplified Prospectus and CEBS in relation to the review of the Large Exposures regime. Both reviews were initiated by the European Commission. CEIOPS is, understandably, focusing its efforts in relation to the ongoing policy work related to Solvency II, which involves a detailed IA exercise. This work will not be completed until October 2009 but will not delay the current process of ratification of the IA guidelines by the L3 Committees.
35. The CESR pilot began in Spring 2007 with the formation of the Key Investor Information (KII) working group, charged with considering how to address the shortcomings of the Simplified Prospectus identified by the European Commission as part of its review of the UCITS II Directive. More specifically, CESR was asked by the European Commission to propose a more effective alternative to the existing Simplified Prospectus disclosure document.
36. The pilot has been widely regarded as a success. The policy makers involved followed the steps in the IA guidelines without difficulty and confirmed that the guidelines were particularly helpful in providing them with a checklist of steps and questions that ensured that they did not inadvertently ignore material issues. In particular the KII working group commented that the IA guidelines were helpful in relation to the identification and presentation of the underlying market and regulatory failures involved. The flexibility of the guidelines was appreciated, given timing and resource constraints. The assistance of the nominated Econet IA experts was also recognised.
37. CESR published a consultation document in October 2007 within which was embedded an impact assessment that included a consideration of the market/regulatory failure that justified the need to improve on existing regulatory requirements, the identification of policy options and a consideration of the relative costs and benefits associated with those options<sup>1</sup>. The options for the design of the revised Simplified Prospectus (the renamed KII

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<sup>1</sup> [http://www.cesr-eu.org/index.php?page=consultation\\_details&id=102](http://www.cesr-eu.org/index.php?page=consultation_details&id=102)



document) will be subject to consumer testing by the European Commission. The Commission intends also to study the implications of the revised Simplified Prospectus in quantitative terms.

38. The CEBS pilot began in January 2007 but was less straightforward than the CESR pilot because the working group responsible for the review of the Large Exposures regime had already undertaken a significant amount of work before the decision to use this work stream for the purposes of piloting the IA guidelines was taken. As a result, working group members found it harder to reconcile the requirements of the IA process with the ongoing working practices that they had adopted. It has been noted that, given the relative inexperience of working group members in relation to IA exercises there would in future be a need both to ensure that working groups receive advice about and, possibly, training on the features of an IA exercise that they might be required to undertake.
39. Nevertheless, no fundamental shortcomings were identified in relation to the IA guidelines (notwithstanding some concerns about the clarity of certain aspects of the guidelines which it is hoped have since been addressed) and CEBS has published two consultation documents (in September and December 2007) that together included a market/regulatory failure analysis, and a consideration of policy options and their associated impacts<sup>2</sup>.
40. The CEIOPS Solvency II pilot is ongoing and it is too early to draw conclusions at this stage. As stated above, the fact that the pilot is ongoing does not stand in the way of the process of ratifying the guidelines at this stage. CEIOPS has given a mandate to its Financial Stability Committee (FSC) to provide advice on IA to the expert groups tasked with carrying out IA as part of the policy making process in regard to Solvency II, work which is ongoing.
41. The key learning point emerging from the pilots relates not to the content or construction of the IA guidelines themselves but to the need to ensure that appropriate advice and, potentially, training is given to policy makers involved in the L3 Committees' expert groups at the beginning of any policy making exercise. In this regard, it is worth noting that the L3 Committees held an oversubscribed and highly successful joint IA training exercise in October 2007. There has been widespread agreement that the IA process has reinforced what are already effective mechanisms for stakeholder engagement in the policy making process, both formal and informal.

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<sup>2</sup> [http://www.c-ebs.org/press/documents/LE\\_Part%202\\_07122007.pdf](http://www.c-ebs.org/press/documents/LE_Part%202_07122007.pdf)



42. The L3 Committees have also since held IA training initiatives of their own and are engaging L3 Committee IA experts to inform policy makers in a variety of L3 expert groups of the IA requirements that they face in relation to a number of L3 Committee work streams (for example in relation to the review by CEBS of CRD-related Options and National Discretions).



## Annex 1 : Consultation responses

Asociacion de Mercados Financieros

Association Francaise de la Gestion Financiere

Association of Foreign Banks (UK)

CNMV Advisory Committee

Danish Securities Dealers Association

Danish Shareholders Association

European Banking Federation

European Forum of Securities Association

European Fund and Asset Management Association

European Insurance & Reinsurance Federation (CEA)

Federation des Experts Comptables Europeens

Federation of European Securities Exchanges

Finnish Association of Securities Dealers

Icelandic Financial Services Association

Industry Panel of the Irish Financial Regulator

International Swaps and Derivatives Association

Norwegian Securities Dealers Association

Securities Industry and Financial Markets Association