

## Summary: Intervention & Options

Department /Agency:  
**HM Treasury**

Title:  
**Impact Assessment of UK Statutory Instrument for  
Credit Rating Agencies**

Stage: FINAL

Version: FINAL

Date: 19 March 2010

**Related Publications:** European Commission Impact Assessment  
[http://ec.europa.eu/internal\\_market/securities/docs/agencies/impact\\_assesment\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/agencies/impact_assesment_en.pdf)

**Available to view or download at:**

[http://www.hm-treasury.gov.uk/consult\\_ria\\_index.htm](http://www.hm-treasury.gov.uk/consult_ria_index.htm)

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

The EC Regulation on Credit Rating Agencies (CRAs) applies from 7 December 2009. The EC Regulation is a Community harmonising measure. It is intended to create a common regulatory approach to credit ratings in the EU.

The rationale for the SI is that the EC Regulation provides for certain national implementing measures (eg on penalties), and they ensure that the EC Regulation is fully effective and enforceable in the UK.

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

The benefits of designating the FSA as competent authority and drawing upon an established enforcement process, penalties, and appeal process is that it gives legal and regulatory certainty to CRAs who will then be dealing with a well established body and enforcement regime. This will be the least costly option for CRAs who may otherwise have to pay higher fees to establish a new oversight body.

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

Option 1: Designate FSA as competent authority

Option 2: Designate a different competent authority to the FSA or create a new body

Option 3: Do nothing.

The preferred option is to designate the FSA as the competent authority i.e option 1. It is possible that this role may be taken over by the proposed European Securities & Markets Authority (ESMA) on 1 January 2011.

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

The Committee of European Securities Regulators (CESR) will publish an annual report on the application of the EC Regulation by December 2010.

**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:

## Summary: Analysis & Evidence

<b>Policy Option: 1</b>	<b>Description: FSA as competent authority</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' £262,500 is estimated as the cost to the FSA from June 2010 to January 2011 including all policy and legal staff involved, and their associated overheads such as facilities, premises and general operation. The average annual cost is the estimated cost of running this oversight function annually as may be required by ESMA.
	<b>One-off</b> (Transition) <b>Yrs</b>	
	£ <b>262,500</b> 10	
	<b>Average Annual Cost</b> (excluding one-off)	
	£ <b>450,000</b>	<b>Total Cost (PV)</b> £ <b>4,454,972</b>
Other <b>key non-monetised costs</b> by 'main affected groups' The transitional costs of establishing and moving to ESMA oversight are not yet quantifiable, however, they will be the same in all three options.		

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>	Description and scale of <b>key monetised benefits</b> by 'main affected groups' It has not been possible to monetise the benefits of having transparent, independent and objective CRAs. CRAs play an important role in financial markets and are used to help make informed investment decisions therefore well governed CRAs help increase market confidence in the quality of ratings.
	<b>One-off</b> <b>Yrs</b>	
	£	
	<b>Average Annual Benefit</b> (excluding one-off)	
	£	<b>Total Benefit (PV)</b> £
Other <b>key non-monetised benefits</b> by 'main affected groups' There are very clear but unquantifiable benefits to option 1. Designating the FSA as competent authority is likely to bring synergies with other FSA work and be in practice the best way of meeting EU requirements. The Regulation assumes that the regulator will be a CESR member (and the FSA already is).		

**Key Assumptions/Sensitivities/Risks :** We have used the average annual costs over 10 years. The supervision of CRAs may be transferred to ESMA in January 2011, although any slippage in time will not affect the choice of options.

Price Base Year 2010	Time Period Years 10	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £ - 4,454,972
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	7 June 2010				
Which organisation(s) will enforce the policy?	FSA				
What is the total annual cost of enforcement for these organisations?	£ 450,000				
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?	£ 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 Nil</td> <td style="width: 25%; text-align: center;">Small Nil</td> <td style="width: 25%; text-align: center;">Medium 50,000</td> <td style="width: 25%; text-align: center;">Large 150,000</td> </tr> </table>	Micro Nil	Small Nil	Medium 50,000	Large 150,000
Micro Nil	Small Nil	Medium 50,000	Large 150,000		
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    £ Nil	Decrease of    £ Nil	<b>Net Impact</b> £ Nil

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

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

### 1. BACKGROUND

Some Credit Rating Agencies in the EU are already subject to the External Credit Assessment Institution (ECAI) regime. Credit ratings may be used for regulatory capital purposes under the Capital Requirements Directive only if the CRA has been recognised under the ECAI regime. ECAIs are recognized as eligible for that purpose by regulatory authorities such as the FSA.

However CRAs were strongly criticised for their role in the market turmoil of 2008, and the Commission under the French Presidency pushed for an EU regulatory response. The Commission consulted on an EU registration regime for CRAs, together with supervisory oversight and enforcement, and a proposed Regulation was published on 12 November 2008.

The Credit Rating Agency Regulation (EC) No 1060/2009 was published on 17 November 2009 and entered into force on 7 December 2009. In summary, it:

- Introduces a harmonised approach to the regulation of credit rating activities in the European Union.
- Establishes a registration system for credit rating agencies.
- Requires registered agencies to comply with various provisions relating to independence, conflicts of interest, employees and analysts, methodologies and models, outsourcing, and disclosure and presentation of information.
- Requires specified financial institutions to use credit ratings for regulatory purposes only if they have been issued or endorsed by a registered CRA, or issued by an overseas agency that has been certified in accordance with the Regulation.

The Regulation is directly applicable, which means it is binding in its entirety and has legal effect in the UK without needing to be transposed. However, the CRA Regulation provides for national implementation, for example to deal with matters such as penalties, enforcement procedures and appeals from registration decisions. This impact assessment, and accompanying evidence base, deals only with the UK Statutory Instrument.

### ESMA

It is possible that the European Securities and Markets Authority (ESMA) will supervise CRAs as from January 2011. There may be additional costs for the industry when this happens although these are not quantifiable at this time. It is expected that the FSA will continue to play a part in the oversight of CRAs going forward.

## **POLICY OPTIONS**

We have looked at three options in considering how best to approach the implementation of the national measures.

### **2. OPTION 1 – Designating the FSA as competent authority**

#### Benefits

Designating the FSA as competent authority clearly brings benefits to the regulation of CRAs. It is difficult to quantify such a benefit, but due consideration should be given to using the existing enforcement regime and the specialist staff and knowledge at the FSA. This translates to good and proper regulation of CRAs and therefore to the maintenance of market confidence, and, ultimately, to investment in the marketplace.

#### Costs

The FSA estimate that they will spend £262,500 on the regulation of CRAs from June 2010 to January 2011. This cost comprises policy, legal and enforcement resource and is inclusive of both personnel cost and all staff overheads such as facilities, premises, travel and using the existing FSA infrastructure. In addition, the FSA estimate that ongoing annual costs may be around £450,000 as it is expected that CRAs will still have to pay annual fees to the FSA who will continue to have an oversight role after the establishment of ESMA.

Costs incurred by the establishment of ESMA are as yet unquantifiable. However, they will be the same costs incurred independent of which policy option in this evidence base is chosen as the creation of ESMA is independent of our approach to UK implementation.

### **3. OPTION 2- Designating a different body as competent authority or creating a new competent authority to take on the role of regulating CRAs.**

#### Benefits

The benefits of creating a new body as competent authority would, in theory, be the same as the benefits described in Option 1. CRAs would be subject to proper regulation and market confidence would benefit as a result.

#### Costs

It is estimated that it would cost at least £1.5m to establish a new body with the necessary supervisory, policy and authorisation experience to conduct the registration of CRAs. This cost is an estimated one, but it is clear in principle that the costs of establishing a new body would be higher than having an existing body take on the role. The cost of this option would therefore be significantly higher than the costs incurred in Option 1 and this would most probably be reflected in the level of fees CRAs would be expected to pay.

The conclusion can be reached that option 2 would present significantly higher costs than option 1. In addition, it is an implicit assumption of the EC Regulation that the competent authority be a member of the Committee of European Securities Regulators (CESR). The FSA is the only UK member of CESR. Option 2 does not therefore appear to be a viable option.

#### OPTION 3 – Do nothing

Under this option, the UK would not implement the national measures to deal with matters such as designating a competent authority, penalties, enforcement procedures, and appeals. In principle, not implementing regime change is frequently considered as part of an evidence base so that the costs and benefits of each option can be compared.

#### Benefits

Costs incurred by the industry and indeed the FSA are likely to be less than under options 1 and 2. It is debatable as to whether they would actually reduce to zero due to the direct applicability of the European regulation.

Benefits to industry and market confidence would be substantially reduced from option 1 and 2, as there would not be a system of proper regulation of CRAs.

#### Costs

The UK would run the risk of infraction proceedings if national measures are not implemented. Other member states are implementing the regulation and so the UK would possibly be put at a disadvantage competitively.

Option 3 is not therefore a viable option.

#### 4. COMPETITION ASSESSMENT

The UK SI will have no effect on competition

#### 5. IMPACT ON SMALL FIRMS

There will be no impact on small firms

#### 6. EQUALITY ASSESSMENTS

The legislation should have no impact on race, disability, gender equality.

#### 7. HUMAN RIGHTS

The legislation will have no impact on human rights

## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

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	No	No
Rural Proofing	No	No

## Annexes

European Impact Assessment

[http://ec.europa.eu/internal\\_market/securities/docs/agencies/impact\\_assesment\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/agencies/impact_assesment_en.pdf)

**Draft SI**