# Economics for Effective Regulation

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**Disclaimer:**
Personal views not those of the FCA

# Summary

These slides were presented by Pete Lukacs of the Financial Conduct Authority (FCA) at the launch workshop of the UKCN consumer remedies project held at the Competition and Markets Authority on 20 September 2016. The theme of this workshop was 'linkages between consumer behaviour and remedies'.

This presentation reviews the FCA's 'Economics for Effective Regulation' occasional paper, which was published on 3 March 2016.

The presentation begins by setting out the broad aims of this paper before describing some of the reasons that prompted its publication and the underlying principles that shaped its design.

Next, the presentation provides an overview of the main methodological stages introduced in the paper. It finishes with a detailed walkthrough of the three key stages of problem diagnosis, intervention design and impact assessment that includes some commentary on the issues that arise under each of those stages.

# What is EFER?

Broad aims of the paper:

1. Argue for the need to update regulatory economic analysis to reflect modern developments and the value of such modern market-focused analysis throughout regulatory decision process.
2. Set out a methodological structure to help this in practice

**Economics for Effective Regulation**. FCA Occasional Paper 13, March 2016. (Iscenko, Z., Andrews, P., Dambe, K., and Edmonds, P.)
Available at https://www.fca.org.uk/news/occasional-paper-no-13

# Why?

Responds to changes in the FCA's objectives and duties

- Increased focus on market analysis
- Integrating behavioural biases into traditional market analysis
- Addressing dynamic market responses and the developments in Behavioural Industrial Organisation
- Challenges of CBA and to estimate benefits from interventions

# Some basic principles

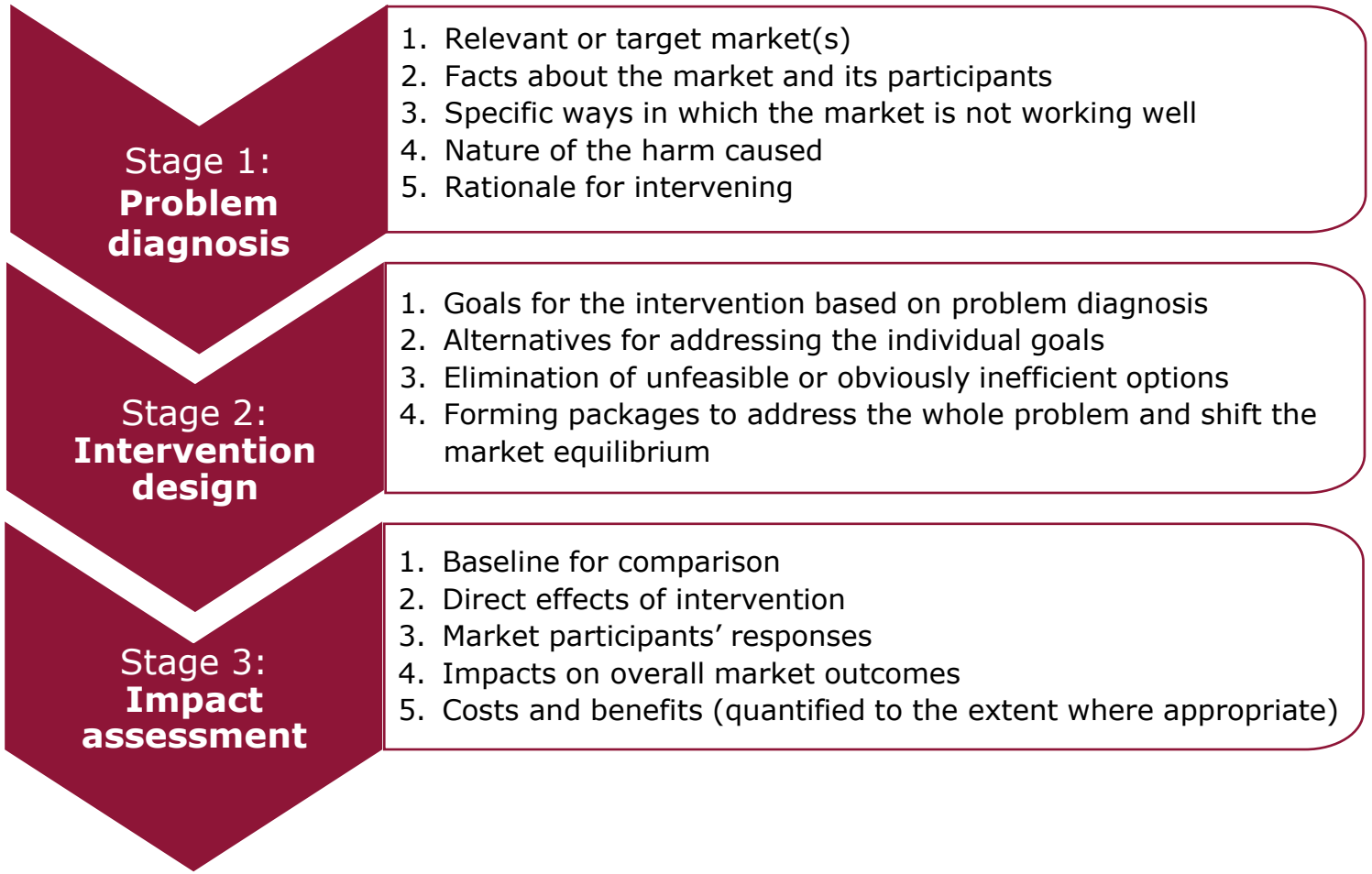
1. Understanding how the market works as a whole is key because poor outcomes often arise from interactions of multiple underlying causes

2. Tackling just one of the identified distortions without thinking about broader context often does more harm than good. Need close links between remedies and problems

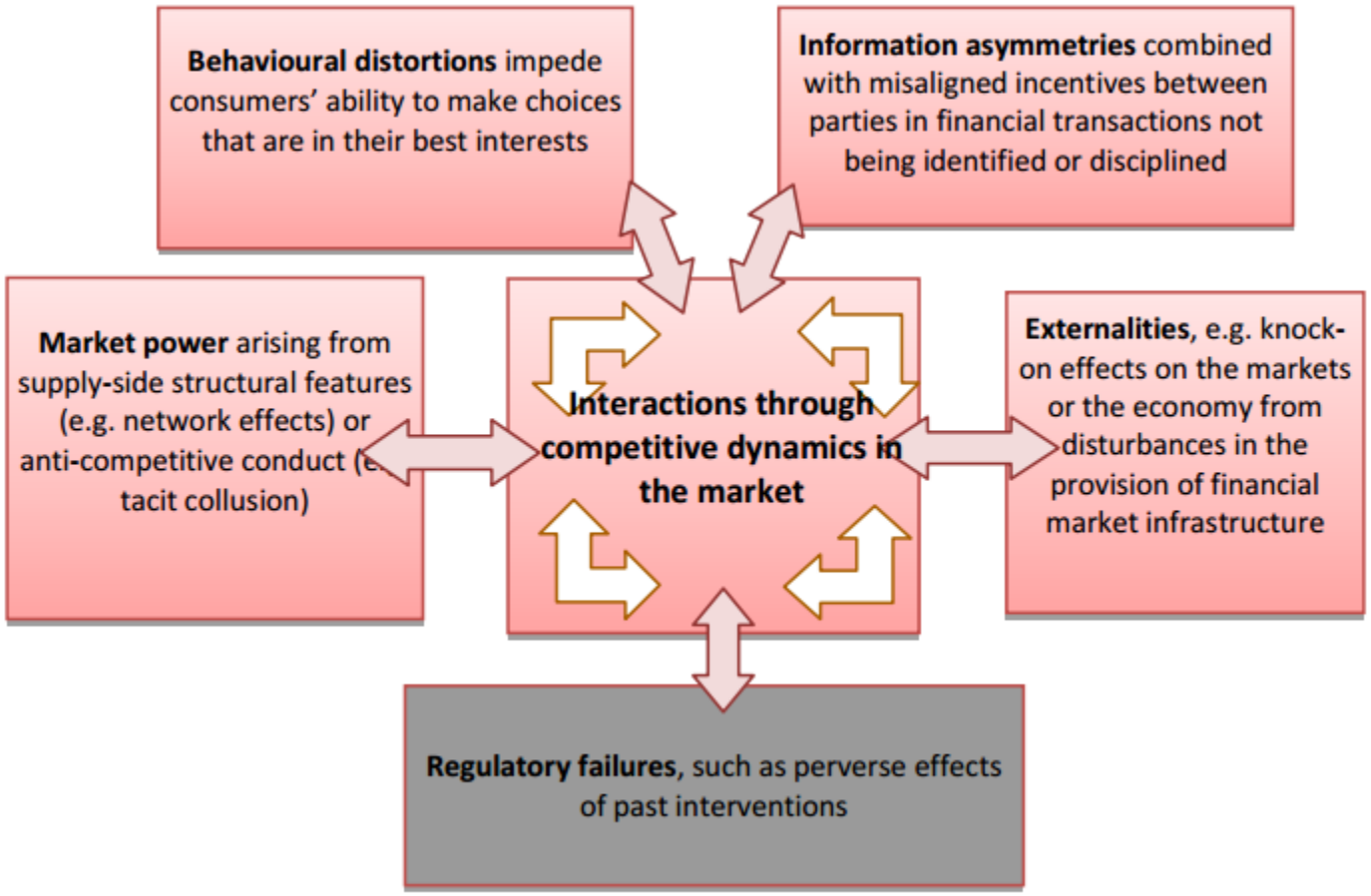
3. Most important impacts of significant interventions are often indirect, so important to analyse participants' responses

**Recognise this is difficult and so aim to provide structure and support.**

# The Process of EFER



# Core idea: interactions in a market and imperfections



# Stage 1 – Problem Diagnosis

Beware of

…superficial claims of behavioural biases

…and isolated jigsaw pieces

# Stage 2 – Intervention design

1. State the goals for the intervention based on problem diagnosis

2. Identify alternatives for addressing the individual goals

3. Eliminate unfeasible or highly inefficient alternative options

4.Combine individual actions into packages to address the whole position

# Two categories of interventions

## Remedies

- Fix the underlying root causes of the problem tackling market failure
  **Examples:**
- Effective disclosure of conflict of interests
- Simplifying product comparisons

## Mitigants

- Mitigate or prevent symptoms and/or directly contain detriment
  **Examples:**
- Banning or constraining products
- Price regulation
- Supervisory action to limit exploitation of weak competition

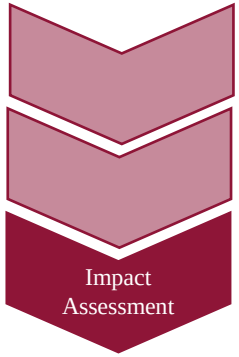
# Two approaches to remedies

Helping imperfect consumers become the best decision makers they can be

Or

Taking consumer imperfections as given and changing market incentives

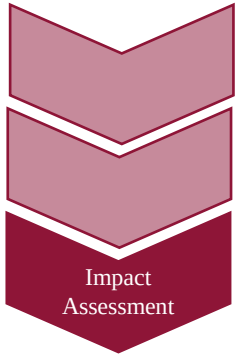
# Stage 3 – Impact assessment




6 potential indirect impacts of financial regulation:

| | |
|---|---|
| **Providers pass compliance costs to consumers** | Consumers are empowered to choose a product/service that suits their needs, leading to more effective competition |
| Withdrawal of existing products/services, or stifling of innovation in the future | Providers recoup the lost revenues from other product/service features or other business lines (waterbed effect) |
| Regulation makes it more or less difficult for smaller providers to compete (barriers to entry/expansion) | Providers get around the rules or minimise their impact |

# Stage 3 – Impact assessment




**Survey of 100 Cost Benefit Analyses across a range of organisations**

- Less than a third had partial monetisation of benefits
- Half did not provide ranges for estimates or reflect uncertainty of estimates
- Four contained explicit attempt at quantifying welfare analysis and these were 'high level'

The challenge to regulators: how to maximise the chances of their interventions making society better off.

# Questions