

## Funding of Basel 2/CRD Firm-Specific implementation work FY2005/06

### SUMMARY FOR FIRMS

1. For the full year 2004/05, an estimated 25 person years will have been spent by FSA on the Basel Firm-Specific Implementation project. This amounts to around £2.3mn, including all direct staff costs (including pension and flexible benefits but not overheads) and the cost of external training packages. The Special Project Fee ('SPF') charged to fund Basel implementation preparations raised £1mn towards this. This was a round figure contribution to fund additional staff, with the intention of building up to a total of 20 staff recruited or deployed exclusively on this project. To date, 6 supervision staff have been deployed to work on the project full time in their respective Business Units and 6 risk specialists have been recruited into RRD with recruitment continuing. External recruitment has been slower than expected in a thin market and in competition with firms.
2. For 2005/06 we will continue to build up the total number of staff recruited or deployed exclusively on this project to this base number of 20. Moreover, if market conditions permit and provided there were room within the FSA's budgetary control total, we will recruit up to five further staff members, the cost of whom the FSA will absorb. Equally if the resource scarcity drives the price up we may not be able to reach the target of 20. In addition to those specific staff, numerous others will be working on the project on issues such as co-operation with overseas supervisors in Europe and further afield, managing the waiver process, reporting requirements, Pillar 2, firm-specific work, training etc. We estimate the total effort under such headings for FY2005/06 to be an average of 36 person years, costing, say, £3.6mn. (Even that excludes the policy work on finalising Handbook requirements.) As in 2004/05, FSA would expect to absorb some of these costs internally but will be seeking to recover a substantial element from the industry.
3. In 2004/05 the SPF was envisaged as a one-off. From 2005/06, waiver application fees, to recover the cost of the model assessment work, were expected to be flowing in earnest, with the CRD due to be implemented in full at end-2006. However, the draft CRD, published in July this year confirmed that the EU had decided to delay the implementation of the most advanced approaches by one year until end-2007. This has the impact of reducing significantly the application fees that the FSA might receive in FY2005/06. There remains uncertainty over the timetable and we cannot rule out the possibility that the whole implementation will yet be delayed until end-2007, which might eliminate application fee income in 2005/06 completely.
4. We therefore plan a combined approach for 2005/06 which will ensure that we raise sufficient funds in a timely manner while still maintaining the link between fees and the cost of carrying out the model review work. The key elements of this proposal are:
  - a) a further SPF in FY2005/06, which effectively means charging our largest UK banks and securities dealers based on their size. Whilst FSA would absorb a substantial element of the total costs in 2004/05, we envisage an SPF of £2mn for 2005/06.
  - b) charging firm-specific waiver application fees, set at a level that reflects the amount of work required to assess each application.

The papers and meetings of the group are intended to encourage useful discussion of the issues rather than to present a comprehensive account of the matters concerned or a set of agreed conclusions. The minutes of the meetings report the discussions of the group, but neither the papers or minutes nor any reported remarks by anyone present at one of those meetings should be read as representing formal positions of the institutions represented or of the FSA. The FSA's Handbook proposals will be subject to consultation in the normal way.

## Special project Fees

- The Special project fee of £2 million has been calculated at a level which will allow the FSA to resource appropriately for the waiver application process, taking into account anticipated waiver application fees and costs financed by the FSA.

## Waiver Application Fees

- The following table illustrates possible levels of waiver application fee. It is based on the expected costs of assessment of the models and takes account of relative contributions by FSA senior management, relationship managers, Basel 2 ‘super-users’, Policy staff and Risk Review staff.
- Application fees will be based on the firm’s chosen IRB or AMA approach and on the complexity of the firm. Complexity will be based on a division of firms into four groups. We have considered various measures of ‘complexity’ and have decided to use criteria that are objective. Firms in Group 1 would be those with a significant overseas element defined as ‘five or more significant overseas entities making use of the models’. For Groups 2, 3 and 4, Modified Eligible Liabilities (MELs) would be used as a proxy for complexity for deposit takers, as set out in the table below. For investment banks we plan to use the fee block determinant of number of traders as a proxy. We are giving consideration to the fee that would be paid by a firm that is in both the deposit takers fee block and the investment firm fee block: a possibility is to use both in combination in which case the firm overall would be placed in the more complex group of the two. Note that MELs and number of traders already form the basis of normal FSA fees for the fee blocks of deposit acceptors (A.1) and firms trading as principal (A.10) respectively. The following table summarises the application fee groups.

Definition of Groups	Group 1	Group 2	Group 3	Group 4
Deposit Takers	5 or more significant overseas entities making use of the models	MELs > \$40bn	MELs ≤ £40bn and MELs > £5bn	MELs ≤ £5bn
Investment Banks	5 or more significant overseas entities making use of the models	No of traders over [200].	No of traders in range [26 to 200].	No of traders [25] or fewer.

- The table below gives, for each combination of Group and Approach, a range of average costs for processing waiver applications. The range reflects internal planning assumptions that have yet to be settled regarding the scale of work and the selection of resources to be applied in each case. These will be finalised for the January 2005 CP on fees. The fee will be set at a level which will, so far as we can achieve it, recover the average of costs across the population of firms that fall within each cell. Costs include the use of staff time directly related to processing applications, including benefits, pension and employers’ National Insurance contributions. No allowance for overheads has been included.

Average Costs (based on staff costs )	Group 1	Group 2	Group 3	Group 4
Advanced IRB/Retail	£[141-219]k	£[113-204]k	£[69-82]k	About £[35]k
Foundation IRB/Retail	£[103-190]k	£[82-175]k	£[50-62]k	About £[25]k
AMA	£[59-161]k	£[59-146]k	£[30-42]k	About £[20]k

- Application fees would be set at a level to recover the average costs envisaged for each combination of approach and group.

## Summary of fees for 2004/05 and 2005/06

10. Assuming that the SPF for 2005/06 is calculated pro-rata to that for 2004/05 and using our latest estimates of which approaches firms plan to adopt, the total costs to firms (including (i) SPF 2004/05; (ii) SPF 2005/06; (iii) estimated IRB fee; (iv) AMA fees where applicable) range from approximately £700k – 750k down to £30k for a simple case. At present, these costs exclude fees arising for those firms which ‘move up’ to AIRB having previously applied for FIRB (for which there could be a case to charge only a top-up fee if the second application were made within a reasonable (say 18 month) timeframe of the first).
11. FSA will adjust periodic fees to account for any under-recovery of its costs and will review application fees after the first year in the light of experience.
12. A summary of costs, projected SPFs and projected level of waiver application fee receipts that is consistent with the replies to our letters is set out in the table below. Note that the application fee receipts in the table below for FY 2005/06 have been calculated as 50% of the sum implied by the responses to our letters. This reduction has been made for two reasons. First, to mitigate the risk that some firms who believe now that they will be ready to apply in 2005/06 will subsequently decide they need more time (this was our experience when implementing the Capital Adequacy Directive). Second, these figures will need to cover costs that will fall in 2006/07 e.g. final visits, decision-taking etc.

	FY2004/05	FY2005/06
<b>Costs of implementation</b>	<b>£2.3mn</b>	<b>£3.6mn</b>
Special project fee receipts	£1.0mn	£2.0mn
Application fee receipts	£0.0mn	£0.6 - £0.9mn
Costs absorbed by FSA	£1.3mn	£0.7 - 1.0mn

13. FSA will consult in January 2005 on the SPF for 2005/06 and on proposed application fee amounts (based on the above amounts supplemented by further analysis of the replies from firms).