Aligning the Financial Services Compensation Scheme levy time period

Consultation Paper
CP18/1

January 2018

How to respond

We are asking for comments on this Consultation Paper (CP) by 5 February 2018.

You can send them to us using the form on our website at: www.fca.org.uk/cp18-01-response-form

Or in writing to:
Clare Vicary
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London
E14 5HS

Telephone:
0207 066 7606

Email:
cp18-01@fca.org.uk

How to navigate this document onscreen

returns you to the contents list

takes you to helpful abbreviations

Contents

1 Summary

Why we are consulting

1.1 Following consultation, including with the Financial Services Compensation Scheme (FSCS), we recently made changes to the FSCS funding arrangements as part of a broader review of FSCS funding. One of the changes was to align the FSCS compensation levy year with the financial year. We have since become aware that a practical implication of this change is a different allocation of costs to the life and pensions intermediation class which was not intended. We think it is reasonable to now consult on transitional provisions which delay the effect of this change meaning in effect that we maintain the status quo. The provisions will ensure that the life and pensions intermediation class will continue to benefit from support from the retail pool[1] over the next few months, consistent with the FSCS's public messaging on this.

Who this applies to

1.2 This consultation will be of interest to all firms who are current or potential contributors to FSCS funding.

1.3 Under current Financial Conduct Authority (FCA) rules, FSCS contributions:

- are required from firms that provide investments, or intermediate investments, general insurance, life insurance and home finance
- may be required from firms that provide insurance, home finance or that accept deposits
- will be required from certain consumer credit firms from 1 April 2018

1.4 The proposal we are consulting on does not directly affect financial services consumers. However, FSCS levies can indirectly affect the prices paid by financial services consumers.

The wider context of this consultation

1.5 The FSCS is the United Kingdom's (UK) statutory compensation scheme of last resort. The FCA decides – for the financial activities we have responsibility for – how much protection the FSCS provides and how it is funded.

1 See para 2.3 for further explanation of how the retail pool works.

1.6 In consultation paper (CP) 16/42[2] we explained that the FSCS compensation levy year runs from 1 July to the following 30 June.[3] However, the separate management expenses levy – which firms pay at the same time as the compensation costs levy – is calculated from 1 April to 31 March. These different time periods make it more complicated for the FSCS to forecast the levy and make it difficult for firms to budget for the levy. To address this, we consulted on rules to allow these periods to be aligned with the financial year. The effect of the rules was to bring the start of the next compensation period forward by three months to 1 April 2018.

1.7 In CP 17/36[4] we explained that most respondents supported the proposal to align the compensation levy year with the management expenses levy year and we made final rules that will come into effect from April 2018.

What we want to change

1.8 We are consulting on transitional provisions to:

- allow the 2017/18 compensation levy year to run to its original timeframe
- require the FSCS to run a nine-month compensation levy year for the period 1 July 2018 to 31 March 2019 with pro-rated class thresholds
- delay the introduction of arrangements for firms who pay fees on account by one year until 1 April 2019

1.9 We are also consulting on minor clarifications to the new rule about levy paying arrangements for firms who pay fees on account.

Outcome we are seeking

1.10 The new rules bring the start of the next compensation levy year forward by three months to 1 April 2018, aligning it with the financial year. Since making the rules, we have become aware that the change in the compensation levy year is likely to cause a different allocation of costs to the life and pensions intermediation class, causing it to lose some of the support it would otherwise have had from the retail pool within this and the next financial year. This was not our intention when we made the rules.

1.11 Firms in the life and pensions intermediation class have already been charged levies up to the class threshold of £100m for 2017/18.[5] In April 2017, the FSCS told the industry that the forecast costs for the life and pensions intermediation class were expected to be higher than the £100m threshold.[6] As a result, the FSCS may need to raise an additional supplementary levy on the retail pool later in the year if this is needed.

2 https://www.fca.org.uk/publication/consultation/cp16-42.pdf
3 The compensation levy year is from July to June because, while the FSCS generally announces the amount of the levy each April, a firm actually only pays it around July.
4 https://www.fca.org.uk/publication/consultation/cp17-36.pdf
5 https://www.handbook.fca.org.uk/handbook/FEES/6/Annex2.html
6 https://www.fscs.org.uk/globalassets/publications/12april2017_outlook_final.pdf

1.12 Our proposed transitional provisions will allow the FSCS to run the current compensation levy year to its original timeframe, ending on 30 June 2018, and would pro-rate the compensation calculations and applicable levy limits in respect of all FCA classes - except for the debt management claims class - for the period from 1 July 2018 to 31 March 2019. The new debt management claims class will be levied on the basis of the year running from April 2018 to March 2019 because the class is new and therefore unaffected by the changes we recently made to align the levy and financial years. Protection for claims about the loss of client money in relation to the activities of debt counselling and debt adjusting will start from 1 April 2018.

1.13 The proposals relating to the arrangements for firms who pay on account are intended to mitigate some of the complexity in the calculation of levies for the next financial year, while also addressing a potential ambiguity in the operation of the relevant rule.

Wider effects of this consultation

If we do not introduce the proposed transitional provisions, firms in the life and pensions intermediation class may have to pay more levies over time than they expected to.

1.14 As the FSCS explained in its publication in April 2017, firms in this class expected to have access to the retail pool until June 2018.

Equality and diversity considerations

1.15 We have considered the equality and diversity issues that may arise from our proposals.

1.16 Overall, we do not consider that the proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. But we will continue to consider the equality and diversity implications of the proposals during the consultation period, and will revisit them when publishing the final rules.

1.17 In the meantime we welcome your input to this consultation on this issue.

Next steps

We would like your views on the proposal set out in this document.

1.18 Please send us your comments by 5 February 2018. You can use the online response form on our website or write to us on the address on page 2.

We will consider your feedback and publish any final rules in the February Handbook notice.

2 Proposals for consultation

2.1 In this chapter we explain our proposal to introduce transitional provisions to:

- allow the 2017/18 compensation levy year to run to its original timeframe – to 30 June 2018
- allow the FSCS to run a nine month compensation levy year for the period 1 July 2018 to 31 March 2019 with pro-rated class thresholds
- delay the introduction of arrangements for firms who pay fees on account by one year until 1 April 2019

2.2 We are also consulting on minor clarifications to the new rule about levy paying arrangements for firms who pay fees on account.

2.3 FSCS compensation costs and specific costs – such as claims handling costs and other expenses related to paying claims - are funded by levies collected from individual firms. A participant firm's permissions determine which funding class – or classes – it belongs to. A firm's compensation costs levy or specific costs levy in the FCA funding classes is proportionate to the size of its annual eligible income and the amount of FSCS compensation that its funding class will have to pay.

2.4 Each of the FCA funding classes is subject to a levy limit or class threshold to ensure that firms' contributions to the FSCS are affordable and sustainable. If compensation costs in a particular funding class are so high that the class threshold is breached, the FSCS may allocate any costs above the threshold to the retail pool. If the retail pool is triggered in this way, the additional costs are distributed between firms in all of the other FCA classes (but only up to their respective class thresholds).

2.5 Firms in the life and pensions intermediation class have already been charged levies up to the class threshold of £100m for 2017/18.[7] In April 2017, the FSCS told the industry that the forecast costs for the life and pensions intermediation class were expected to be higher than the £100m threshold.[8] As a result, the FSCS may need to raise an additional levy on the retail pool later in the current levy year to cover any shortfall that might arise.

2.6 While it remains our intention to align the compensation levy year with the financial year, to do so at this point would alter the allocation of expected compensation costs. When we made final rules in CP 17/36, we did not intend to alter the FSCS's plans to raise a supplementary levy, or reduce the support the life and pensions intermediation class would otherwise receive from the retail pool within this and the next levy year. However, in light of additional information we now consider that changing the start date of the next compensation levy year would have this effect. We are therefore proposing a transitional period between the 2017/18 and 2018/19 financial years that is intended to preserve the level of support the life and pensions intermediation class receives from the retail pool.

7 https://www.handbook.fca.org.uk/handbook/FEES/6/Annex2.html
8 https://www.fscs.org.uk/globalassets/publications/12april2017_outlook_final.pdf

2.7 The transitional provisions that we are proposing will enable the FSCS to run the currently compensation levy year to its original end point on 30 June 2018. The practical effect of this is that the FSCS would be able to raise a supplementary levy on the retail pool to cover compensation costs for the 2017/18 compensation levy year if it needs to do so and as it had originally planned.

2.8 The proposed transitional provisions will require the FSCS to implement a nine-month compensation levy year running from 1 July 2018 to 31 March 2019, with pro-rated annual levy limits. This aims to ensure that the life and pensions intermediation class (and other classes that can be supported by the retail pool) retain the same level of support from the retail pool they would have otherwise had.

2.9 We are also proposing to delay the introduction of new arrangements for firms that pay fees on account. Firms subject to FEES 6.7.-1R would be required to pay an estimated half of their share of annual levies in April of each year (based on the previous year's levy), and the balance in September. We consider that the transitional period we are proposing would add complexity to the operation of FEES 6.7.-1R, making the calculation of levies less transparent to firms and generating significant administrative costs to the FCA. Delaying the introduction of these new arrangements by one year will reduce the number of invoices that the FCA will need to issue to firms. This will reduce costs and the administrative burden on firms, the FCA and the FSCS. From 1 April 2019 the FSCS compensation levy year and the management expenses levy year will be aligned and firms will be levied accordingly.

2.10 We have also identified a potential ambiguity in FEES 6.7.-1R, in that it would appear to apply to interim levies. This would undermine the ability of the FSCS to raise funds as necessary to meet its ongoing compensation and specific costs. We are consulting on amendments to clarify that FEES 6.7.-1R does not apply to interim levies.

Q1: **Do you agree with our proposal to allow the current compensation levy year to run to its original timeframe to 30 June 2018?**

Q2: **Do you agree with our proposal for a nine-month levy year with pro-rated class thresholds for the financial year of 2018/19 – 1 July 2018-31 March 2019?**

Q3: **Do you agree with our proposal to delay the introduction of the aligned twelve month levy year until 1 April 2019?**

Q4: **Do you agree with our proposed clarification to FEES 6.7.-1R?**

Q5: **Do you have any alternative proposals?**

Annex 1
Questions in this paper

Q1: **Do you agree with our proposal to allow the current compensation levy year to run to its original timeframe to 30 June 2018?**

Q2: **Do you agree with our proposal for a nine-month levy year with pro-rated class thresholds for the financial year of 2018/19– 1 July 2018–31 March 2019?**

Q3: **Do you agree with our proposal to delay the introduction of the aligned twelve month levy year until 1 April 2019?**

Q4: **Do you agree with our proposed clarification to FEES 6.7.-1R?**

Q5: **Do you have any alternative proposals?**

Annex 2
Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. The proposed transitional provisions are aimed at addressing unintended consequences to the allocation of compensation and specific costs to the retail pool in this and the next financial year, but do not affect the overall amount of compensation (or specific) costs which the FSCS incurs or funds through levies. We consider that any increase in costs will be of minimal significance. On that basis, under s. 138L(3) of FSMA we are exempt from the requirement to carry out and publish a cost benefit analysis.

3. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

4. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

5. In addition, we have also considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.

6. This Annex includes our assessment of the equality and diversity implications of these proposals.

7. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

Designing a compensation scheme: s213 of FSMA

8. The proposed rule is designed to ensure that the scheme remains sufficiently funded. The FSCS told firms in April 2017 that the forecast costs for the life and pensions intermediation class were expected to be higher than the £100m threshold and that the FSCS may need to raise an additional levy on the retail pool later in the year. Creating these transitional provisions ensures that the life and pensions intermediation class are not required to pay more than they would have done before the rule changes we made in October 2017.

The FCA's objectives and regulatory principles: Compatibility statement

9. The proposals set out in this consultation are compatible with the FCA's strategic objective of ensuring that the relevant markets function well. The availability of compensation increases consumer confidence when engaging with financial services. The proposals also advance the FCA's consumer protection objective.

10. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because firms in the Life and Pensions Class expected to be able to access the retail pool until the end of June 2018. For the purposes of the FCA's strategic objective, "relevant markets" are defined by s. 1F FSMA.

11. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA.

The need to use our resources in the most efficient and economic way

12. The technical amendment is meant to be a more efficient and economic proposal than implementing the aligned levy years in April 2018 as previously planned. Delaying the introduction of arrangements for firms who pay fees on account until 1 April 2019 will reduce the number of invoices that the FCA will need to issue to firms. This will reduce costs and the administrative burden on firms, the FCA and the FSCS.

The principle that a burden or restriction should be proportionate to the benefits

13. The technical amendment is intended to ensure that firms in the Life and Pensions Intermediation Class are required to pay a proportionate share of the levy over time and can access the retail pool for the time period they expected after the FSCS publication in April 2017.

The principle that we should exercise of our functions as transparently as possible

14. The reasons for the proposals are set out in detail in the consultation paper. Additionally, in formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA). However, the proposals and issues under discussion do not have a direct bearing on financial crime.

15. In formulating these proposals, the FCA has had regard to the importance of taking action intended to minimise the extent to which it is possible for a business carried on (i) by an authorised person or a recognised investment exchange; or (ii) in contravention

of the general prohibition, to be used for a purpose connected with financial crime (as required by s. 1B(5)(b) FSMA). This is not relevant to the proposals in this CP.

The general principle that consumers should take responsibility for their decisions

16. Our proposals do not alter the position of the FSCS as a compensation scheme of last resort. They are therefore compatible with the principle that consumers should take responsibility for their own decisions.

Expected effect on mutual societies

17. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.

Compatibility with the duty to promote effective competition in the interests of consumers

18. In preparing the proposals in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers.

Equality and diversity

19. We are required under the Equality Act 2010 to 'have due regard' to the need to eliminate discrimination and to promote equality of opportunity in carrying out our policies, services and functions. As part of this, we conduct an equality impact assessment to ensure that the equality and diversity implications of any new policy proposals are considered. Whilst the imposition of FSCS levies in general may be a barrier to entry for some firms, we consider it is justified by the consumer protection benefits. The proposed transitional provisions do not affect the overall cost to the industry from FSCS levies.

20. The outcome of the assessment in this case is stated in paragraph 1.16 of the Consultation Paper.

Treasury recommendations about economic policy

21. The proposal set out in this paper is relevant to the 'better outcomes for consumers' aspect of the Government's economic policy. The transitional provision will help to ensure that the scheme remains sufficiently funded.

Appendix 1
Draft Handbook text

FINANCIAL SERVICES COMPENSATION SCHEME (TRANSITIONAL LEVY PROVISIONS) INSTRUMENT 2018

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the powers and related provisions in:

(1) the following sections of the Financial Services and Markets Act 2000 ("the Act"):

(a) section 137A (The FCA's general rules);
(b) section 137T (General supplementary powers);
(c) section 139A (Power of the FCA to give guidance);
(d) section 213 (The compensation scheme);
(e) section 214 (General); and

(2) the other powers and related provisions listed in Schedule 4 (Powers exercised) to the General Provisions of the Handbook.

B. The rule-making powers listed above are specified for the purpose of section 138G (Rule-making instruments) of the Act.

Commencement

C. The transitional provisions in Part 1 of Annex B come into force on [23 February 2018].

D. The remainder of this instrument comes into force on [1 April 2018].

Amendments to the Handbook

E. The Glossary of definitions is amended in accordance with Annex A to this instrument.

F. The Fees manual (FEES) is amended in accordance with Annex B to this instrument.

Citation

G. This instrument may be cited as the Financial Services Compensation Scheme (Transitional Levy Provisions) Instrument 2018.

By order of the Board
[*date*]

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate position. The text is not underlined.

annual levy	the first *management expenses levy* and the first *compensation costs levy* in any one financial year of the *compensation scheme*.
interim levy	a levy imposed by the *FSCS*, other than an *annual levy*.

Annex B

Amendments to the Fees manual (FEES)

In this Annex, underlining indicates new text and striking through indicates deleted text.

Part 1: Comes into force on [23 February 2018]

FEES TP 18 (Transitional provisions relating to changes to the FSCS levy arrangements taking effect in 2018/19) is amended as follows.

TP 18 Transitional provisions relating to changes to the FSCS levy arrangements taking effect in 2018/19

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional Provision	(5) Transitional provision: dates in force	(6) Handbook Provisions coming into force
Reporting requirements					
18.1	*FEES* 6.5.13R	R	…	…	…
Managing investments in relation to structured products					
18.2	*FEES* 6 Annex 3AR	R	…	…	…
Matters arising before 1 April 2018					
[To follow from 1 April 2018]					
2017/18 financial year: compensation levies					
18.4	*FEES* 6.3.1R(3), 6.1.6G, and 6.1.14G	R	In relation to an interim *compensation costs levy* within the 2017/18 financial year of the *compensation scheme*, the *FSCS* must take into account the *FSCS*'s expenditure in respect of *compensation costs* expected in the period until 30 June 2018 instead of expenditure expected in the periods in the provisions in column (2).	From 23 February 2018 to 31 March 2018	Already in force

2018/19 financial year: levies and levy limits					
18.5	*FEES* 6.3.1R(3), 6.1.6G and 6.1.14G	R	In relation to a *compensation costs levy* for the 2018/2019 financial year of the *compensation scheme*, the *FSCS* must take into account: (1) the *FSCS*'s expenditure in respect of *compensation costs* expected between 1 July 2018 and 31 March 2019; or, if greater (2) 75% of one third of the *compensation costs* expected in the 36 *months* following 1 April 2018, instead of expenditure expected in the periods in the provisions in column (2).	From 1 April 2018 to 31 March 2019	Amended from 1 April 2018
18.6	*FEES* 6.3.5R, 6.5A.1R, 6.5A.4R, 6.5A.5R, 6 Annex 2R, and 6 Annex 5R	R	In the 2018/19 financial year of the *compensation scheme*, the maximum aggregate amount of *compensation costs* and *specific costs* that may be allocated to a particular *class*, whether directly or (where relevant to that *class*) through the *retail pool*, is: (1) 75% of the amount of the limit for each *class* as set out in *FEES* 6 Annex 2R; and (2) for *FCA provider contribution classes*, 75% of the amount of the *retail pool* levy limit for each *class* as set out in *FEES* 6 Annex 5R.	From 1 April 2018 to 31 March 2019	Amended from 1 April 2018
18.7	*FEES* 6.3.1R(3), 6.1.6G and 6.1.14G, 6.3.5R, 6.5A.1R, 6.5A.4R, 6.5A.5R, 6 Annex 2R, and 6 Annex 5R	R	TP 18.5 and 18.6 do not apply in respect of levies imposed on the debt management *class*.	From 1 April 2018 to 31 March 2019	From 1 April 2018 to 31 March 2019

18.8	*FEES* 6.7.1-1R	R	*FEES* 6.7.-1R does not apply to levies imposed in the 2018/2019 financial year of the *compensation scheme*.	From 1 April 2018 to 31 March 2019	Amended from 1 April 2018

Part 2: Comes into effect on [1 April 2018]

[*Editor's note*: the following provisions in FEES 6, as amended by the Financial Services Compensation Scheme (Funding and Scope) Instrument 2017 (FCA 2017/58) with effect from 1 April 2018, are amended as follows.]

6 Financial Services Compensation Scheme Funding

…

6.3 The FSCS's power to impose levies

…

6.3.2A G The *FSCS* will usually levy once in each *financial year* (the *annual levy*). However, if the *compensation costs* or *specific costs* incurred, or expected to be incurred, exceed the amounts held, or reasonably expected to be held, to meet those costs, the *FSCS* may, at any time during the *financial year*, do one or more of the following:

(1) impose an ~~interim *compensation costs levy* or management expenses levy~~ *interim levy*; or

…

…

6.7 Payment of levies

Payments on account by certain firms

6.7.-1 R Where a *participant firm* must pay its periodic fees for a *fee year* in accordance with *FEES* 4.3.6R(1C) to (1E), it must pay its share of any ~~levy made~~ *annual levy* imposed by the *FSCS* for the *financial year* of the *compensation scheme* ~~which is the same as that *fee year*~~ as follows:

(1) by 1 April an amount equal to 50%, or such lower percentage as the *FSCS* may determine, of the *participant firm*'s share of the ~~levy~~ *annual levy* payable for the previous *financial year* of the *compensation scheme*; and

(2) by 1 September the balance of the ~~levy~~ *annual levy* due from the *participant firm* for the current *financial year* of the *compensation scheme*.

…

Payments of interim levies

6.7.3A R A *participant firm*'s share of any ~~interim levy~~ *interim levy* is due on, and payable within 30 *days* of, the date when the invoice is issued.

…

Appendix 2
Abbreviations in this document

CP	Consultation Paper
FCA	Financial Conduct Authority
FSCS	Financial Services Compensation Scheme
UK	United Kingdom

Pub ref: 005586

FINANCIAL CONDUCT AUTHORITY

25 The North Colonnade Canary Wharf London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk