Bank of England
Prudential Regulation Authority

FINANCIAL CONDUCT AUTHORITY

Consultation Paper
FCA CP23/3**
and
PRA CP1/23

Financial Services Compensation Scheme – Management Expenses Levy Limit 2023/24

January 2023

How to respond

We are asking for comments on this Consultation Paper (CP) by **9 February 2023**

You can send them to us using the form on our website.

Or in writing to:

Prudential & Redress Policy
Financial Conduct Authority
12 Endeavour Square London
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cp23-3@fca.org.uk

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Chapter 1

Summary

Why we are consulting and the wider context

1.1 In this Consultation Paper (CP), we – the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) – set out proposals for the Management Expenses Levy Limit (MELL) for the Financial Services Compensation Scheme (FSCS) for 2023/24. This CP is supported by the FSCS's Proposed Budget Update for 2023/24 published alongside this CP.

1.2 The FSCS is a fund of last resort to provide compensation for consumers when financial services firms fail. Its other functions include:

- making recoveries from failed financial institutions
- promoting consumer awareness of FSCS protection and
- verifying account information that firms provide to enable faster pay-out to depositors

1.3 Under section 223 (1) of the Financial Services and Markets Act 2000 (FSMA), a limit must be set for the total management expenses that the FSCS can levy on financial services firms. The MELL is the maximum amount that the FSCS may levy in a financial year for its operating costs without further rule-making by the FCA and the PRA after consultation. Setting the right MELL ensures that the scheme has sufficient funding to exercise the functions conferred on it by Part XV of FSMA and by rules made by the FCA and the PRA.

Who this applies to

1.4 This CP is relevant to all FCA and PRA authorised firms. It is not of direct relevance to retail financial services consumers or consumer groups and they do not need to act on it.

1.5 As costs may be passed onto consumers in the form of higher prices, consumers may indirectly meet part of the FSCS levies. However, an efficient and adequately funded compensation scheme benefits all consumers.

Summary of the proposal

1.6 The proposed MELL for 2023/24 is £109.8 million consisting of:

- the FSCS management expenses budget of £99.8 million
- an unlevied reserve of £10 million

1.7 The proposed MELL is £0.7 million lower than the 2022/23 MELL of £110.5 million.

1.8 The MELL would apply from 1 April 2023, the start of the FSCS's financial year, to 31 March 2024.

1.9 More details on the MELL, how it is calculated and an explanation of the FSCS's unlevied reserve can be found in Chapter 2 and in the FSCS's 2023/24 Budget Update.

Equality and diversity considerations

1.10 We have considered the equality and diversity issues that may arise from the proposals in this CP.

1.11 Overall, we do not consider that the proposals materially 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 making the final rules.

Structure of the CP

1.12 Chapter 2 of this CP contains the proposals for the MELL for 2023/24. The key points to note in the budget are set out, alongside further detail on the proposals and an explanation of the FSCS's unlevied reserve. How the budget is allocated between the FCA and the PRA funding classes is also provided and explained in Appendix 4.

1.13 Annex 2 of this CP contains an analysis of the costs and benefits of the proposed rules as required under FSMA. The FCA's and the PRA's consideration of the compatibility of the proposed rules with their respective statutory objectives (including the secondary competition objective) and regulatory principles is also provided and explained in Annex 3. The FCA and the PRA also assess whether they have carried out their duty to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out their policies, services and functions.

Next steps

1.14 This consultation closes on 9 February 2023. Please send any comments on the proposed MELL using the online response form on the FCA's website.

1.15 The FCA is accepting responses on behalf of both the FCA and the PRA, and both authorities will consider the responses.

1.16 Subject to the responses to this consultation, the FCA will then issue a Handbook Notice and the PRA will publish a Policy Statement so that final rules can be in place for the start of the FSCS's financial year on 1 April 2023.

Chapter 2

Proposals for the MELL 2023/24

2.1 In this chapter, we set out the proposals for the FSCS's MELL for 2023/24. The MELL covers the costs of operating the compensation scheme. It is the maximum amount, without further consultation and rule-making by the FCA and the PRA, that the FSCS can levy in a year for its operating costs to fulfil the obligations imposed on it by FSMA and set out in the FCA and the PRA rules. These comprise of the COMP and FEES 6 section of the FCA Handbook and the Depositor Protection Part, the Policyholder Protection Part, and the Management Expenses in Respect of the Relevant Schemes Part of the PRA Rulebook.

2.2 The MELL has two components: the management expenses budget and an unlevied reserve (contingency reserve). The MELL does not include compensation costs which are levied separately and are determined by the FSCS. Paragraphs 2.12-2.14 give further details on this.

2.3 The FSCS's actual expenses for the year may differ from its budget as this will be based on the total number and type of claims it receives. At the end of the financial year, the FSCS will reconcile the actual expenses for the year against the total amount levied and the allocation across the funding classes.

2.4 Any changes will be reflected by providing rebates or using any unspent levies to reduce firms' future levies.

2.5 The proposed rules through which the FCA and the PRA would set the MELL are in Appendices 1 and 2 respectively. Both the FCA Board and Prudential Regulation Committee (PRC) considered the proposals for the MELL and gave approval for the consultation.

Management expenses budget

2.6 The proposed management expenses budget for 2023/24 is £99.8 million. The management expenses budget covers the FSCS's ongoing operating costs, and includes IT, staff, outsourcing, legal and claims handling costs. Appendix 3 provides a breakdown of management expenses by line item.

2.7 The management expenses budget represents an increase of 5% (£4.3 million) over the 2022/23 management expenses budget of £95.5 million. Most of the increase can be attributed to a £3.9 million increase to the FSCS's proposed spend in the area of investments (see paragraph 2.21). There is also an increase of £3.2 million in controllable costs, the key drivers of which are mainly related to increased staff costs (see paragraph 2.22) and communication costs that will support efforts to increase awareness of the FSCS.

2.8 The FSCS recognises that it needs to use its resources in the most economical and efficient way. It is committed to delivering a high level of service, while keeping its costs as low as possible.

Unlevied (contingency) reserve

2.9 The unlevied reserve (otherwise known as the contingency reserve) is an important part of the FSCS's approach to management expenses and ensures that in the event of increasing claims volumes the FSCS can continue to fulfil its statutory obligations. It allows the FSCS to raise additional funds at short notice to meet costs that were not foreseen or planned for when the management expenses levy was raised. The unlevied reserve can be levied without further consultation by the FCA and the PRA.

2.10 The proposed unlevied reserve for 2023/24 is £10 million, which is £5 million lower than the reserve of the current and previous financial year. The uncertainty caused by the Covid-19 pandemic caused challenges in accurately forecasting claims volumes and, as a result, the unlevied reserve was increased to £15 million in 2021/22 and remained at the same level for 2022/23. However, the FSCS did not use any of its unlevied reserve in 2021/22 and it is not expecting to use it this year as claims volumes and associated costs have been lower than budget. The unlevied reserve was last used in 2020/21 when it was set at £5 million.

2.11 The FSCS is mindful of the current economic situation and has indicated that it does not want to levy more than is required upfront. It has considered the certainty of events and has included only firm failures where there is good intelligence that they will arise in 2023/24, while ensuring it can be flexible to address any unexpected increases in claims volumes. The FSCS has reviewed the level of unlevied reserve required and considers that £10 million is an appropriate level for the reserve. The FSCS accepts that there is a greater risk of requiring access to the unlevied reserve in 2023/24 than in previous years.

Compensation costs

2.12 The FSCS's compensation costs levy, which covers compensation paid to consumers, is determined separately by the FSCS and does not form part of this consultation. It is directly linked to the level of compensation claims received from consumers and agreed for pay-out.

2.13 The FCA recognises the problem that high costs have for firms, especially in the current challenging economic climate and continues to work to reduce the impact of firm failures with a longer-term aim of lowering future compensation costs. In December 2022, the FCA published a Feedback Statement as part of its review of the compensation framework. The feedback statement provides an overview of the feedback received to the FCA's previous discussion paper and sets out next steps for the Compensation Framework Review. This includes ongoing work to tackle the underlying causes of high FSCS compensation costs to bring down the compensation costs falling to industry levy payers and to reduce the harm suffered by consumers upon firm failure.

2.14 The FSCS will indicate its current estimate of compensation costs and its related funding and levies in its 2023/24 Budget Update, due to be published on 12 January 2023, and confirm the final levies in spring 2023.

Management Expenses Budget further detail

2.15 In this section, the FSCS's proposed management expenses budget is broken down by activity, with information on the main changes from last year's budget. The FSCS has distinguished between volume and complexity driven costs (costs sensitive to changes in claim volumes and type) and controllable costs (costs which are not sensitive to changes in claims volumes). In addition, investment costs, which the FSCS defines as costs required to deliver on its statutory objectives, priorities and strategic ambition for the next 3 years, have been factored into its budget proposals as part of its multi-year investment programme.

2.16 The proposed budget includes a £3.9 million increase in investment spend compared to 2022/23. Controllable costs are increasing by 5.8%, which is £1.5 million below the agreed target of keeping controllable costs within flat real, after adjusting for inflation at 8.6% (Source: Office of National Statistics (ONS) September 2022).

2.17 The proposed increase to the investment budget is driven by the FSCS's ambition to deliver the strategic aims of the organisation. The FSCS is seeking to improve its operational efficiency and its efforts to help reduce the levy burden on industry through better consumer outcomes. The FSCS recognises that the environment it currently operates in has changed considerably over recent years. In particular, it now requires an enhanced claims handling model with supporting processes and technologies to efficiently process the more complex claims it is now seeing in areas such as defined benefit pension transfer, self-invested personal pensions (SIPP) operators and EEA (European Economic Area) firms. The key initiatives from this investment budget will enable the FSCS to evolve and meet the challenges and future demands of its customers and stakeholders. This is discussed in more detail in paragraph 2.21.

2.18 The FSCS is currently forecasting an underspend of £6.3 million compared to the 2022/23 management expenses budget of £95.5 million. If this forecast materialises these funds will be used to offset the levy for the relevant classes in 2023/24.

Table 1: Management expenses: Activity-based costing (£million)

ABC Category	2023/24 Budget				2022/23 Budget				Variance	
	Budget	Controllable costs	Volume and complexity driven	Investments	Budget	Controllable costs	Volume and complexity driven	Investments	Total	Total %
Claims handling infrastructure and support	**75.9**	**41.9**	**34.0**	**-**	**74.2**	**37.4**	**36.8**	**-**	**1.7**	**2%**
Outsourced claims handling	13.7	-	13.7	-	21.7	-	21.7	-	-8.0	37%
Internal claims processing	22.9	6.1	16.8	-	18.9	6.3	12.6	-	4.1	22%
Core support: IT, facilities and central services	39.3	35.9	3.4	-	33.7	31.1	2.6	-	5.6	17%
Funding readiness	**8.0**	**8.0**	**-**	**-**	**8.0**	**8.0**	**-**	**-**	**-**	**0%**
Protection, recoveries, investment and pension deficit	**15.9**	**8.0**	**-**	**7.9**	**13.3**	**9.3**	**-**	**4.0**	**2.6**	**19%**
Consumer protection	0.8	0.8	-	-	0.9	0.9	-	-	-0.1	11%
Depositor protection	3.8	3.8	-	-	3.5	3.5	-	-	0.2	6%

ABC Category	2023/24 Budget				2022/23 Budget				Variance	
	Budget	Controllable costs	Volume and complexity driven	Investments	Budget	Controllable costs	Volume and complexity driven	Investments	Total	Total %
Recoveries	2.7	2.7	-	-	3.0	3.0	-	-	-0.3	11%
Investment	7.9	-	-	7.9	4.0	-	-	4.0	3.9	97%
Pension deficit funding	0.8	0.8	-	-	1.9	1.9	-	-	-1.1	58%
Total management expenses	**99.8**	**57.9**	**34.0**	**7.9**	**95.5**	**54.7**	**36.8**	**4.0**	**4.3**	**5%**

Key points to highlight

2.19 **Claims-handling infrastructure and support:** This makes up the largest part of the management expenses budget, amounting to £75.9 million or 76% of the total budget and allows the FSCS to carry out its core function of handling claims following firm failure.

- Outsourced claims handling costs are budgeted at £13.7 million. This is a reduction of £8 million from last year's budget. It reflects a 44% reduction in the number of claims that will be outsourced in 2023/24. This is mainly due to claims volumes being 32% lower than the 2022/23 budget and as the FSCS recruited and trained additional specialist claims handlers. However, some of the savings in this area have been offset by increases to outsourcer resource costs.
- Internal claims handling support costs are budgeted at £22.9 million. This is an increase of £4.1 million on the 2022/23 budget and reflects a 22% increase to

the level of claims processed internally, thereby building on the FSCS's internal capacity and capability to process complex claims.

- Core support includes IT, facilities and central service costs, and amounts to £39.3 million. This is an increase of £5.6 million to take account of a rise in staff headcount (which is discussed in paragraph 2.22), communications costs to increase awareness of the FSCS and IT costs.

2.20 **Funding readiness:** The FSCS maintains a borrowing facility, available within one business day to fund pay-outs following significant firm failures. The cost of the facility, bank charges and processing fees, is expected to remain constant at £8 million.

2.21 **Consumer protection, depositor protection, recoveries, investment and pension deficit:** The FSCS proposes a budget of £15.9 million for these areas:

- Spending on depositor protection is budgeted to increase by £0.3 million to £3.8 million. This is driven by continued spending to maintain overall awareness, and Single Customer View (SCV) systems that allow the FSCS to be given the information they need to make sure customers get paid on time when a deposit taker fails.
- Spending on consumer protection, which is intended to improve consumer awareness of FSCS products and services, is budgeted to reduce by £0.1 million to £0.8 million.
- £2.7 million has been budgeted for recoveries and will include a focus on cases relating to illiquid funds and Professional Indemnity Insurance. The budget for recoveries is down from £3 million last year. The FSCS Budget Update and its November Outlook gives more information on this.
- Spending on investment is budgeted to substantially increase by £3.9 million to £7.9 million and forms the first phase of the FSCS's 3-year investment plan. The focus of this spending will be on three categories.

  - Customer focused (proposed £4.2 million spend):

    - Primarily to determine the most suitable claims processing model as well as identifying process efficiencies and technology enhancements for pension and insurance products, which the FSCS are seeing increasing claims for.
    - To develop systems and processes to respond to expected changes in statutory requirements following regulatory consultation processes.
    - To progress the pre-defaults processes including £0.2 million for the development of alternative ways of compensating depositors and supporting the PRA's work on Improving Depositor Outcomes in Bank Insolvency (IDOBI).

  - Technology (proposed £1.9 million spend):

    - To ensure the technology estate is kept up to date, secure and deliver the services the FSCS needs alongside exploring the technology options to help achieve its strategic ambition.
    - To complete the Cloud migration project through optimising the system architecture and key system upgrades.

    - To improve the FSCS's security posture to deal with emerging cyber and security threats.
- Insight and Data (proposed £1.8 million spend):
    - Mainly to develop the FSCS's data and insight, policy and stakeholder capability to identify where the most impact can be made in preventing consumer harm.
    - To complete transformation of the consumer awareness measures and revise the 'FSCS protected' materials for the first time in a decade.

Staff Costs

2.22 Staff costs are included within the activity-based spending categories. The FSCS proposes a staff budget of £31.9 million, an increase of £4.7 million on last year. This will facilitate an increase in staff headcount of 17 full-time equivalent (FTE) and provide a headline 4% for pay inflation, which will be focused on areas with greater retention risk and the lower paid. 2% of the staff budget is allocated to one-off and targeted support to address recruitment hot spots and the cost-of-living challenges.

2.23 As noted above the FSCS is planning an increase of 17 full-time equivalent (FTE) staff made up of 6 apprenticeship roles, with other roles predominately to support capabilities in areas such as stakeholder engagement, cyber security, data management and service management. A number of roles in Legal, Data and Technology and Customer Support are being proposed to enhance internal capability and reduce reliance on expensive external consultancy costs.

Budget allocation

2.24 The management expenses budget component of the MELL is made up of:

- A base costs element – related to the general running costs of the FSCS (and is not dependent on the level of claims received). Base costs are split 50:50 between the FCA and PRA regulatory classes and then allocated in proportion to regulatory fees.
- A specific costs element – which includes the costs of assessing claims, achieving recoveries and making payments relating to a particular funding class (FSCS funding classes comprise groupings of activities regulated by the FCA and the PRA for which the FSCS offers protection: management expenses are allocated proportionately between these classes).

2.25 The FSCS's proposed base costs are £38.3 million and the proposed specific costs are £61.5 million.

2.26 Appendix 4 contains a breakdown of the FSCS's proposed budget by funding class. The FCA funding class allocation would decrease by £4.5 million, and the PRA funding class allocation would increase by £0.5 million.

2.27 The proposed reduction in the FCA funding class allocation is mainly due to a projected 71% reduction to the General Insurance Distribution class reflecting the continuing reduction of Payment Protection Insurance claims volumes. The proposed increase in PRA classes is due to the increased internal capability to handle claims in the General Insurance Provision class to deal with new failures (e.g. MCE Insurance Company), and to deal with the number of firms in run off (currently 29).

2.28 Further information on the FSCS's proposed management expenses budget is in its 2023/24 Budget Update published on 12 January 2023 on the FSCS website.

Annex 1

Questions in this paper

Q1: **Do you have any comments on the proposed FSCS MELL for 2023/24?**

Annex 2

Cost benefit analysis

Introduction

1. Sections 138I and 138J FSMA, as amended by the Financial Services Act 2012, require the FCA and the PRA to publish a cost benefit analysis (CBA). Specifically, sections 138I and 138J requires the FCA and the PRA respectively, before making rules, to (a) consult each other, and (b) after doing so, publish a draft of the proposed rules in the way appearing to them to be best calculated to bring them to the attention of the public. The draft rules must be accompanied by a CBA, being an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made.

2. This analysis presents estimates of the significant impacts of our proposal. We provide monetary values for the impacts where we believe it is reasonably practicable to do so. For others, we provide estimates of outcomes in other dimensions. Our proposals are based on carefully weighing up these multiple dimensions and reaching a judgement about the appropriate level of consumer protection, taking into account all the other impacts we foresee.

3. The costs and benefits are illustrated by setting them against a baseline of the MELL not being levied and the FSCS not paying out. The incremental changes in the MELL this year are a fraction of the figures set out in this CBA (see paragraph 2.7).

Benefits

4. Setting the MELL at £109.8 million ensures the FSCS can continue to operate and to meet its objective of providing a compensation scheme that is efficient, fair, approachable and responsive.

5. If a MELL was not set, the FSCS would not be able to operate and provide direct benefits to consumers through the payment of compensation to eligible claimants in the event of firm failure. While the wider benefits of the FSCS are hard to quantify, the direct benefit to consumers from FSCS compensation is expected to be £592 million in 2023/24. This is the FSCS's forecast of the amount to be paid out in compensation for 2023/24 based on known and highly likely claims. The amount is based on an estimate of the number of completed claim decisions, the proportion of claims upheld and the average cost of each claim.

6. The existence of the compensation scheme, where applicable, reduces consumers' financial loss and increases consumer confidence in authorised financial services firms. This is particularly important for depositors, as timely compensation in the event of the failure of a deposit taker helps ensure consumer confidence in the financial system. It is also important given the number of pension related failures so that consumers do not lose their retirement income.

7. Compensation pay-outs are partially offset by the recoveries made by the FSCS from the estates of failed firms or from third parties responsible for the losses.

Costs

8. The one-off direct costs to firms are equal to the budget of £99.8 million. The MELL will be split between the FCA and the PRA funding classes and levied on all authorised firms according to the volume of regulated financial services business they conduct. Appendix 4 provides a summary of how the MELL costs are allocated between the FCA and the PRA classes.

9. Management expenses are charged to firms and may be passed on to consumers in the form of higher prices.

10. The unlevied reserve of £10 million, which is only invoiced to industry levy payers if needed, gives the FSCS some margin to meet costs that exceed its budgeted expenses and that need to be funded at short notice. The FSCS needs to be able to respond quickly and efficiently to firm failures. Should the FSCS require funding beyond the limit imposed by the MELL due to exceptional circumstances, the FCA and the PRA would urgently consider the request.

Summary

11. The FCA and the PRA consider that the benefits of raising the MELL outweigh the costs placed on industry primarily because the provision of compensation in the event of the failure of a financial services firm helps to ensure consumer confidence in the financial system and, where compensation is paid, reduces financial harm.

Annex 3
Compatibility statement

Compliance with legal requirements

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

The FCA's objectives and regulatory principles: Compatibility statement

2. 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 (see paragraphs 9 to 13).

3. The FCA considers that the proposals set out in this consultation are compatible with the statutory objectives. They are primarily intended to advance the FCA's operational objective of consumer protection.

4. The role of the FSCS is, in general, to provide compensation to consumers of financial products when authorised firms are unable, or likely to be unable, to meet their obligations. A compensation scheme provides a safety net, offering protection to consumers, which in turn leads to greater confidence in their dealings with financial services firms, benefitting all firms and leading to a stronger financial system. If the FSCS was unable to process claims because of financial constraints due to an inappropriate MELL this would undermine the protection offered to consumers.

5. The proposal is also considered to be compatible with the FCA's competition duty to promote effective competition in the interests of consumers. Any levy placed on a firm because of this proposal will take into account the firm's size, and as such is not likely to disadvantage specific groups of firms, in particular smaller firms.

6. Subject to this consultation, the FCA considers that the proposed FSCS MELL is appropriate. The limit proposed ensures the FSCS has adequate resources to perform its functions for the coming year. In addition, in setting the MELL for 2023/24, the FCA and the PRA have allowed for sufficient unlevied reserve to prevent disruption to the FSCS's work if it needs to exceed its operating budget for unexpected reasons.

7. When consulting on new rules, the FCA is also under a duty to discharge its general functions in a way which promotes effective competition in the interests of consumers (s. 1B(4) FSMA). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

8. Setting a FSCS MELL has no material significance for the reduction of financial crime objectives.

9. 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 FCA believes that the proposed MELL is compatible with these regulatory principles. The regulatory principles most relevant to this proposal are:

- the need to use the resources of each regulator in the most efficient and economic way
- the principle that a burden or restriction should be proportionate to the benefits

10. The FSCS is operationally independent of, but accountable to, the FCA. This means that the FCA's resources are not directly involved in carrying out the proposed activities.

11. The FCA rules require the FSCS to have regard to the need to use its resources in the most efficient and economic way when carrying out its functions. Setting the MELL, after public consultation, encourages good internal management and effective operating procedures.

12. The FCA believes that an appropriate balance has been struck between the need to ensure their regulatory objectives are fulfilled and the need to keep regulatory burdens proportionate.

13. The FCA's assessment of the fairness and proportionality of the burden and benefits relating to this proposal can be found in the cost benefit analysis section of this CP in Annex 2.

14. The Treasury has made recommendations to the FCA and the PRA about aspects of the Government's economic policy to which the FCA and the PRA should have regard in connection with our general duties. The FCA considers that the recommendations most relevant to the proposals in this CP are:

i. competition
ii. a better outcome for consumers
iii. competitiveness

15. Recommendation (i) has been considered in paragraphs 5 and 7 of this annex and recommendation (ii) in paragraph 5 of Annex 2. With regard to recommendation (iii), the FCA considers that an appropriately funded compensation scheme will enhance consumers' trust in UK regulated firms. This will help to ensure that the UK remains an attractive domicile for internationally active financial institutions, and that London retains its position as a leading financial centre.

The PRA's objectives analysis

16. Under s.2H(2) of FSMA, in discharging its general functions, the PRA must also have regard to the regulatory principles in s.3B.

17. When consulting on proposed new rules, the PRA is required by s. 138J(2)(d) of FSMA to include an explanation of why it believes making the proposed rules is compatible with duties in relation to its general functions.

18. The PRA, under s. 2B FSMA, must, when discharging its general functions, so far as is reasonably possible, act in a way that advances its general objective – i.e. promoting the safety and soundness of PRA-authorised firms.

19. The PRA must carry out that objective primarily by:

- seeking to ensure that the business of PRA-authorised persons is carried out in a way which avoids any adverse effect on the stability of the UK financial system
- seeking to minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system

20. The PRA considers that the proposed rule on setting the MELL is compatible with these statutory obligations. The continued operation of the FSCS with a MELL set at an appropriate level, assists in minimising the adverse effect of the failure of a PRA-authorised person on consumers and so helps promote the stability of the UK financial system as well as confidence in the UK financial system.

21. Under s. 2C FSMA, the PRA has an additional primary objective for insurance. In addition to promoting insurers' safety and soundness, thereby supporting the stability of the UK financial system, it has an insurance objective to contribute to securing an appropriate degree of protection for those who are or may become policyholders. The PRA considers that the proposed rule to set the MELL is compatible with this duty because the continued operation of the FSCS with a MELL set at an appropriate rate assists in securing an appropriate degree of protection for policyholders of a PRA-authorised person that has failed.

22. When discharging its general functions in a way that advances its objectives under ss. 2B and 2C, the PRA must, under s. 2H(1) and 3B of FSMA, so far as is reasonably possible, act in a way which, as a secondary objective, facilitates effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities.

23. The proposals further the PRA's secondary competition objective as the good functioning of the FSCS helps to facilitate orderly exit of firms from the market helping to reduce costs of other levy payers. The MELL is not expected to have any adverse effect on competition as it applies to firms in proportion to their share of FSCS protected business within their funding class. Any levy on a firm as a result of this proposal will take into account the business volume of the firm levied, as well as the claims received in the relevant classes. As such the MELL is not likely to disadvantage specific groups of firms (in particular smaller firms).

'Have Regards' analysis

24. In developing these proposals, the PRA has had regard to the FSMA regulatory principles and the aspects of the Government's economic policy set out in the Treasury recommendations letter of 8 December 2022. The following factors, to which the PRA is required to have regard, were significant in the PRA's analysis of the proposals:

- **The principle that a burden or restriction which is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden (FSMA regulatory principle):** The PRA considers that the proposed measures are proportionate for the reasons set out in the CBA.
- **Transparency (FSMA regulatory principle):** The PRA has had regard to exercising functions in a transparent way by engaging with both the FCA and the FSCS throughout this process, formally consulting with the wider industry, and setting out how the FSCS proposes to spend the levies it plans to charge firms.
- **Supporting the government's objectives of medium to long-term economic growth in the interests of consumers and business (the Treasury recommendations letter):** In general, the role of the FSCS is to provide compensation to consumers of financial products when authorised firms are unable, or likely to be unable, to meet their obligations. A compensation scheme provides a safety net, offering protection to consumers, which in turn leads to greater confidence in their dealings with financial services firms, benefitting all firms and leading to a stronger financial system and supporting growth. The PRA considers that an appropriately funded compensation scheme will enhance consumers' trust in UK regulated firms.
- **International competitiveness (the Treasury recommendations letter):** The PRA considers that an appropriately funded compensation scheme will help to ensure that the UK remains an attractive place for internationally active financial institutions, and that London retains its position as a leading financial centre.
- **The Legislative and Regulatory Reform Act 2006 (LRRA):** In relation to determining the policy approach, the regulator's code and principles under the Legislative and Regulatory Reform Act 2006 (LRRA) are also applicable, which state (inter alia) that the regulators should have regard to the principles that regulatory activities should be carried out in a transparent, accountable, proportionate and consistent way, and activities targeted only where needed. The PRA considers that this duty has been met, including by ensuring the engagement with the FCA and the FSCS early in the process, and consulting with wider industry stakeholders, including levy payers, on the proposed MELL.

Expected effect on mutual societies

25. The FCA and the PRA do not expect the proposals in this paper to have a significantly different impact on mutual societies. Management expenses are levied on all authorised firms including mutual societies according to the volume of regulated financial services they conduct.

Equality and diversity

26. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, and to foster good relations between people who share a protected characteristic and those who do not.

27. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. We do not consider that the proposals adversely impact any of the groups with protected characteristics under the Equality Act 2010. However, we would welcome any comments respondents may have on any equality issues they believe arise as a result of these proposals.

Annex 4

Abbreviations used in this paper

Abbreviation	Description
ABC	Activity-based costing
CBA	Cost benefit analysis
CP	Consultation Paper
EEA	European Economic Area
FCA	Financial Conduct Authority
FEES	Fees manual
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
FTE	Full time equivalent
IDOBI	Improving Depositor Outcomes in Bank Insolvency
LRRA	Legislative and Regulatory Reform Act 2006
MELL	Management expenses levy limit
ONS	Office of National Statistics
PRA	Prudential Regulation Authority
PRC	Prudential Regulation Committee
SIPP	Self-invested personal pensions

We make all responses to formal consultation available for public inspection unless the respondent requests otherwise. We will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Despite this, we may be asked to disclose a confidential response under the Freedom of Information Act 2000. We may consult you if we receive such a request. Any decision we make not to disclose the response is reviewable by the Information Commissioner and the Information Rights Tribunal.

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Appendix 1

FCA Draft Handbook text

FINANCIAL SERVICES COMPENSATION SCHEME (MANAGEMENT EXPENSES LEVY LIMIT 2023/2024) INSTRUMENT 2023

Powers exercised

A. The Financial Conduct Authority (“the FCA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):

(1) section 137T (General supplementary powers);
(2) section 213 (The compensation scheme);
(3) section 214 (General); and
(4) section 223 (Management expenses).

B. The rule-making powers listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

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

Citation

E. This instrument may be cited as the Financial Services Compensation Scheme (Management Expenses Levy Limit 2023/2024) Instrument 2023.

By order of the Board
[*date*]

Annex

Amendments to the Fees manual (FEES)

In this Annex, underlining indicates new text.

6 Financial Services Compensation Scheme Funding

…

6 Annex 1R Financial Services Compensation Scheme - Management Expenses Levy Limit

This table belongs to FEES 6.4.2R	
Period	Limit on total of all management expenses levies attributable to that period (£)
…	
1 April 2022 to 31 March 2023	£110,473,324
1 April 2023 to 31 March 2024	£109,815,710

Appendix 2

PRA Draft rulebook text

PRA RULEBOOK: NON-AUTHORISED PERSONS: FSCS MANAGEMENT EXPENSES LEVY LIMIT AND BASE COSTS INSTRUMENT 2023

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137T (General supplementary powers);
(2) section 213 (The compensation scheme);
(3) section 214 (General); and
(4) section 223 (Management expenses).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

C. In accordance with section 138J of the Act (Consultation by the PRA), the PRA consulted the Financial Conduct Authority. After consulting, the PRA published a draft of proposed rules and had regard to representations made.

PRA Rulebook: Non-Authorised Persons: FSCS Management Expenses Levy Limit and Base Costs Instrument 2023

D. The PRA makes the rules in the Annex to this instrument.

Commencement

E. This instrument comes into force on 1 April 2023.

Citation

F. This instrument may be cited as the PRA Rulebook: Non-Authorised Persons: FSCS Management Expenses Levy Limit and Base Costs Instrument 2023.

By order of the Prudential Regulation Committee
[DATE]

Annex

Amendments to the FSCS Management Expenses Levy Limit and Base Costs Part

In this Annex new text is underlined and deleted text is struck through.

...

2 LIMIT ON MANAGEMENT EXPENSES LEVIES

2.1 ~~The total of all *management expenses levies* attributable to the period 1 April 2022 to 31 March 2023 of the *deposit guarantee scheme* or the *policyholder protection scheme* may not exceed £110,473,324 less whatever *management expenses levies* the *FSCS* has imposed in accordance with *FCA compensation scheme rules* attributable to that period.~~ [Deleted]

2.1A The amount which the *FSCS* may recover from the sums levied under the *compensation scheme* as *management expenses* attributable to the period 1 April 2023 to 31 March 2024 may not exceed £109,815,710.

<u>2.2 This amount is the combined limit in respect of the *deposit guarantee scheme*, the *policyholder protection scheme* and the *FCA compensation scheme rules*.</u>

…

Appendix 3

FSCS management expenses line by line

Budget: Significant items (£m)	2023/24	2022/23	change	% change
Staff costs (including contractors)	**42.7**	**33.4**	**9.3**	**28%**
Staff costs	31.9	27.2	**4.7**	**17%**
Contractors	10.8	6.2	**4.6**	**74%**
Communications	**4.4**	**3.8**	**0.6**	**16%**
Professional, legal and recovery costs	**11.5**	**11.6**	**-0.1**	**-0.9%**
Outsourced claims handling	**14.1**	**22**	**-7.9**	**-36%**
Outsourced claims	13.6	21.4	**-7.8**	**-36%**
Outsourced printing	0.5	0.6	**-0.1**	**-16%**
Investment	**7.9**	**4**	**3.9**	**97%**
Customer	4.2	1	**3.2**	**320%**
Technology	1.9	1.9	**0**	**0%**
Insight and Data	1.8	1.1	**0.7**	**63%**
Credit facility	**8**	**8**	**0**	**0%**
Pension deficit funding	**0.8**	**1.9**	**-1.1**	**-58%**
Facilities, IT and overheads	**11.4**	**10.7**	**0.7**	**6%**
Facilities	2.4	2.2	**0.2**	**9%**
IT	6.5	6.0	**0.5**	**8%**
Depreciation	1.4	1.4	**0**	**0%**
Other/contingency	0.5	0.5	**0**	**0%**
External providers	0.6	0.6	**0**	**0%**
Interest income	**-0.9**	**0**	**0.9**	**-**
Total management expenses	**99.8**	**95.5**	**4.3**	**5%**

Appendix 4

FSCS management expenses by funding class

	2023/24			2022/23			Movement		
	FSCS total costs £m	PRA fee block allocation £m	FCA fee block allocation £m	FSCS total costs £m	PRA fee block allocation £m	FCA fee block allocation £m	FSCS total costs £m	PRA fee block allocation £m	FCA fee block allocation £m
Base costs total (split 50:50)	**38.3**	**19.2**	**19.2**	**29.9**	**15.0**	**15.0**	**28%**	**28%**	**28%**
Specific costs									
Deposits	14.1	14.1		14.1	14.1		0%	0%	
General Insurance Provision	7.6	7.6		7.2	7.2		6%	6%	
Life and Pension Provision	-	-		-	-		-	-	
General Insurance Distribution	1.7		1.7	5.9		5.9	-71%		-71%
Life Distribution and Investment Intermediation	30.3		30.3	27.7		27.7	9%		9%

	2023/24			2022/23			Movement		
	FSCS total costs £m	PRA fee block allocation £m	FCA fee block allocation £m	FSCS total costs £m	PRA fee block allocation £m	FCA fee block allocation £m	FSCS total costs £m	PRA fee block allocation £m	FCA fee block allocation £m
Investment Provision	7%		7%	9.7		9.7	-27%		-27%
Home Finance Intermediation	0.8		0.8	1.0		1.0	-18%		-18%
Debt Management	-		-	-		-	-		-
Specific costs total	**61.5**	**21.7**	**39.8**	**65.6**	**21.2**	**44.3**	**-6%**	**2%**	**-10%**
Management Expenses total	**99.8**	**40.8**	**59.0**	**95.5**	**36.2**	**59.3**	**5%**	**13%**	**0%**

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