

Consultation Paper

CP16/42\*\*\*

# Reviewing the funding of the Financial Services Compensation Scheme (FSCS)



December 2016

# Contents

<b>Abbreviations used in this document</b>	3
<b>1</b> Executive summary	5
<b>Section 1: Who pays? The context for this review</b>	10
<b>2</b> Compensating consumers: who pays?	11
<b>3</b> Professional Indemnity Insurance: is it working?	20
<b>Section 2: Ideas and options for discussion</b>	23
<b>4</b> Risks and responsibilities	24
<b>5</b> Professional Indemnity Insurance: options for change	29
<b>6</b> Extending consumer protection: options for change	33
<b>7</b> Reviewing the funding classes and smoothing costs	41
<b>8</b> Reviewing the funding classes: potential product provider contributions	49
<b>Section 3: Specific proposals for consultation</b>	51
<b>9</b> Extending consumer protection: specific proposals	52
<b>10</b> Risks and responsibilities: reporting requirements	59
<b>11</b> Funding classes and the levy year: specific proposals	61
<b>12</b> Next steps	65
<b>Annex</b>	
<b>1</b> List of questions	66
<b>2</b> Cost Benefit Analysis	70
<b>3</b> Analysis of potential risk measures	75
<b>4</b> Analysis of affordability	90
<b>5</b> Compatibility Statement	100
<b>Appendix</b>	
<b>1</b> Draft Handbook text	103

We are asking for comments on this Consultation Paper by 31 March 2017

You can send them to us using the form on our website at:  
[www.fca.org.uk/cp16-42-response-form](http://www.fca.org.uk/cp16-42-response-form).

**Or in writing to:**

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We have developed the policy in this consultation paper in the context of the existing UK and EU regulatory framework. We will keep the proposals under review to assess whether any amendments will be required due to changes in the UK regulatory framework, including as a result of any negotiations following the UK's vote to leave the EU.

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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## Abbreviations used in this paper

<b>AEI</b>	Annual eligible income
<b>AIF</b>	Alternative investment fund
<b>AUA</b>	Assets under administration
<b>AUT</b>	Authorised unit trust
<b>CASS</b>	Client Assets sourcebook
<b>CBA</b>	Cost benefit analysis
<b>CIS</b>	Collective investment scheme
<b>CoCos</b>	Contingent convertible instruments
<b>COMP</b>	Compensation sourcebook
<b>CONC</b>	Consumer Credit sourcebook
<b>DWP</b>	Department for Work and Pensions
<b>FAMR</b>	Financial Advice Market Review
<b>FCA</b>	Financial Conduct Authority
<b>FOS</b>	Financial Ombudsman Service
<b>FSA</b>	Financial Services Authority (predecessor regulator to the FCA and PRA)
<b>FSMA</b>	Financial Services and Markets Act
<b>FSCS</b>	Financial Services Compensation Scheme
<b>HMRC</b>	Her Majesty's Revenue and Customs
<b>ICVC</b>	Investment company with variable capital
<b>IDD</b>	Insurance Distribution Directive

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<b>IMD</b>	Insurance Mediation Directive
<b>IVA</b>	Individual Voluntary Agreement
<b>LLP</b>	Limited liability partnership
<b>MiFID II</b>	Revised Markets in Financial Instruments Directive
<b>NMPIs</b>	Non-mainstream pooled investments
<b>PIF</b>	Personal Investment Firm
<b>PII</b>	Professional Indemnity Insurance
<b>PPI</b>	Payment Protection Insurance
<b>PRA</b>	Prudential Regulation Authority (part of the Bank of England)
<b>QIS</b>	Qualified investor scheme
<b>RCF</b>	Revolving credit facility
<b>ROA</b>	Return On Assets
<b>RMAR</b>	Retail Mediation Activities Return
<b>RPPD</b>	Responsibilities of Providers and Distributors for the Fair Treatment of Customers
<b>SIPPs</b>	Self-invested personal pensions
<b>SPVs</b>	Special purpose vehicles
<b>TLPIs</b>	Traded life policy investments
<b>UCIS</b>	Unregulated collective investment scheme
<b>UFPLS</b>	Uncrystallised funds pension lump sum

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# 1.

## Executive summary

### Background

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- 1.1** The Financial Services Compensation Scheme (FSCS) is the UK's statutory compensation scheme of last resort. In 2015/16 it paid out £271m in compensation to consumers and received over 46,000 new claims. The FSCS plays a critical role in ensuring consumers can have confidence in the financial services market, but the protection it offers comes at a cost to the industry and ultimately consumers. Firms from across the financial services industry pay levies to fund both the FSCS's operating costs and the compensation it pays out.
- 1.2** The Financial Conduct Authority's (FCA) role is to decide both the extent of protection that the FSCS will provide and how it is funded, for the financial services activities for which we have responsibility.<sup>1</sup> For these activities, this Consultation Paper (CP) looks at how the FSCS is currently funded and how it is funded in the future, and proposes some changes to our rules. This includes seeking views on the current and future interaction between a firm's professional indemnity insurance (PII) and FSCS cover.
- 1.3** In March 2013, the Financial Services Authority (FSA) finished its review of FSCS funding and published final rules,<sup>2</sup> which set out how the FSCS would be funded after the FCA and Prudential Regulation Authority (PRA) were set up. We committed to reviewing the funding model in 2016.
- 1.4** The Financial Advice Market Review (FAMR)<sup>3</sup> also made recommendations about how the FSCS is funded. The FAMR report was published jointly by HM Treasury and the FCA earlier this year, and focused specifically on the investment advice market. It highlighted two areas that are relevant to FSCS funding. These were whether a risk-based levy would be a better way to reflect the risk a firm poses to the FSCS and considering how the unpredictability and volatility of levies could be reduced. We discuss both these areas in this CP.
- 1.5** We believe that the availability of effective PII and the FSCS play a critical role in making financial markets work well. They benefit product providers, intermediaries and consumers.

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1 The Prudential Regulation Authority (PRA) is responsible for certain areas of the FSCS's rules, including those covering claims for deposits and claims under contracts of insurance. This is described further in Chapter 2.

2 The FSA published final rules in PS 13/4, *FSCS funding model review – feedback on CP13/1* (March 2013). This followed on from the FSA's earlier publications, CP12/16, *FSCS Funding Model Review* (July 2012) and CP13/1 *FSCS Funding Model Review – feedback on CP12/16 and further consultation* (January 2013).

3 HM Treasury and FCA, *Financial Advice Market Review – Final report* (March 2016).

## Key issues and concerns

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- 1.6** As the FAMR considered, the scale and impact of FSCS levies has risen sharply for some firms over recent years, particularly those required to contribute towards claims for self-invested personal pensions (SIPPs).<sup>4</sup> This has caused concern about the unpredictability of the levies, and led to calls for a re-think of FSCS funding. Additionally, in some sectors, a relatively small number of firms have been responsible for a large proportion of FSCS compensation claims. We recognise industry concerns about the way that some firms are grouped together for levy purposes, for example, with others who sell products that they themselves do not.
- 1.7** In recent years, FSCS levies have been largely driven by the failure of firms which have given unsuitable investment advice to consumers. Some firms are concerned that this may increase in the future because of the introduction of the pension freedoms, as consumers have more responsibility for saving for a pension and using their pension savings to fund retirement. Many firms across different sectors argue it is unfair that they should have to bear the cost when these firms fail.
- 1.8** We currently require personal investment firms (PIFs) to take out adequate PII cover. There are relatively few PII providers in the PIF market, and some firms can find it difficult to buy appropriate PII policies. We have also seen evidence that some PII policies do not fully meet claims and exclude important aspects from their cover.
- 1.9** As a result, although PII was intended to be one of the main ways for these firms to protect their clients, it is not necessarily reliable. Instead, the FSCS has increasingly taken on the role of 'first line of defence' when a firm fails. We will look at the requirement for these firms to hold PII and its effectiveness to help inform a review of the PII market we will carry out in 2017.
- 1.10** PII pools risks from the advice that firms give and their other activities. To some extent, the premiums that a firm pays reflect its individual level of risk. In contrast, the FSCS 'mutualises' the risk and the cost of firms failing and leaving consumers with claims against them. As part of this review, we want your views on ways to improve the reliability of PII so that it acts as a 'front stop' ahead of firms failing and resulting claims being made on the FSCS. We are also looking at whether the levies that individual firms pay towards the FSCS could better reflect the risks that they pose.

## Our strategic approach

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- 1.11** Taking into account these issues, we believe that we need to carry out a fundamental review of the FSCS levy. Our proposals set out in this document therefore are a mix of more far-reaching proposals for discussion and some immediate consultation proposals.
- 1.12** In approaching this work, we have considered the principles that should underlie our review of the FCA funding classes and the scheme more generally. We must ensure that there will be sufficient funding to compensate claimants who are entitled to receive compensation under our rules. We must also take account of the desirability of ensuring levies on any particular class of firms reflect, as far as possible, the claims that are, or are likely to be, made on that class. In addition, we believe that we should focus on:

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<sup>4</sup> The FSCS's Annual Report and Accounts 2015/16 noted that '...total levies in 2015/16 came to £338m, an increase of £107m. The increase is mainly because of a rise in the levies on the Life and Pensions Intermediaries of £85m, as a result of the increase in SIPP claims.'

- ensuring that the FSCS is a backstop, not the first line of defence when a firm fails
- reducing levy volatility in line with the conclusions of FAMR
- aiming to ensure that firms that benefit from the conditions created by the FSCS pay towards it
- reflecting risk where appropriate
- creating sustainable classes that provide sufficient funding for compensation
- seeking a robust funding model that does not require constant reassessment
- ensuring that the model is economical and practical to implement, and
- meeting consumers' reasonable expectations for protection when things go wrong

### Summary of proposals for discussion

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**1.13** This CP sets out for discussion a range of options for changing both how the FSCS is funded and the coverage it gives consumers. We would like your views on:

- **The PII market and the coverage it provides:** We are looking at whether more comprehensive PII could increase the proportion and value of claims that are covered by insurance when firms fail.
- **Introducing product provider contributions:** We are looking at introducing product provider contributions towards the costs of claims involving intermediary firm failures, reflecting the wider responsibilities of product providers in the process.
- **Changing funding classes for intermediation activities:** We would like your views on various options to smooth costs. These include alternative class structures that merge some or all of the different intermediation classes so that investment, life and pensions, home finance and general insurance intermediation may be grouped together, depending on the option.
- **Risk-based levies:** We are looking at whether FSCS levies should better reflect the risks of specific practices, particularly on firms distributing higher risk products. We also propose a specific rule to introduce data collection for activities linked to higher risk products to help us develop a risk-based approach in future.
- **Updating FSCS compensation limits and activities in light of the pension freedoms:** We would like your views on different options, including whether to increase the limits on claims relating to investment provision and the intermediation of life, pension and investment products. We are also considering extending or increasing the level of coverage of the FSCS in relation to some activities, including products and services used to manage pension savings.

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### Summary of consultation proposals

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- 1.14** In addition to the more fundamental discussion points we wish to raise, we are also consulting on more immediate specific proposals to change the scope and operation of FSCS funding. We have set these out in Appendix 1. They include:
- **Introducing and extending consumer protection:** Extending FSCS coverage for some aspects of fund management and introducing it for debt management and structured deposit intermediation.
  - **Additional reporting requirements:** This will potentially enable us to introduce risk-based levies in the future.
  - **Contributions from Lloyd's of London:** Requiring Lloyd's of London to contribute appropriately to the retail pool, which would be called upon if costs in a particular intermediary funding class were so high that they breached the class's affordability thresholds.
  - **Amend payment arrangements:** Amending payment arrangements so that some firms can be asked to pay a proportion of the levy on account. This would align the amount of the levy to the years that each element is charged for and enable firms and the FSCS to better plan.
- 1.15** We are also consulting on a number of minor changes (also included in Appendix 1) to remove or update redundant references in this area of our Handbook.

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### Alternative options for funding the FSCS

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- 1.16** Any options for funding the FSCS have to balance the protection of consumers against affordability for the firms that pay the levy. As we want to maintain the current level of protection for consumers, we also explored a number of other options, including the FSCS using a credit facility. Under this approach, the FSCS would use its existing credit facility or a similar facility to both spread the costs of significant levies and make levies generally less volatile and more predictable. However, we are aware that the benefits, may be limited, especially as firms themselves already have access to credit to spread their payments individually.

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### Next steps

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- 1.17** We are seeking views both on our detailed proposals in this consultation and the areas that we raise for wider discussion and input. Please send us your comments by 31/03/17. You can use the online response form on our website or write to us at the address on page 2.
- 1.18** We will consider your feedback, report back on it and plan to publish some rules in a Policy Statement next year. We will also consult further in 2017 on specific proposals in those areas where this paper sets out a range of options.

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### Who does this consultation affect?

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- 1.19** This consultation will be of interest to all firms, whether they are current or potential contributors to FSCS funding.
- 1.20** Under current FCA rules, FSCS contributions are required from firms involved in intermediating general insurance, life insurance, home finance or providing or intermediating investments, and may be required from firms providing insurance or that accept deposits. We are also now consulting on rules that will additionally require contributions from certain firms in the consumer credit market.

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### Is this of interest to consumers?

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- 1.21** This consultation may be of interest to consumers, or consumer groups, as it relates to both the funding of the FSCS and the protection it provides. The FSCS is a key source of protection for consumers as it can provide compensation if an authorised financial services firm is unable to meet claims against it. The costs of FSCS levies may also be passed on to consumers.

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### Equality and diversity considerations

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- 1.22** We want to make sure that any changes from our proposals to reform funding classes do not negatively impact protected groups. We recognise that the make-up of consumers using services from general insurance and home finance intermediaries may be different to that of consumers using services from investment, and life and pensions intermediaries (for example, a wider spread of ages may purchase general insurance than investment products). Therefore any proposal for merging classes might imply a cross-subsidy from one group of consumers to another, at least in the short term. We would welcome your feedback on this and on the impact of our proposals in this CP on equality and diversity more generally. Please include your comments in response to our questions on specific proposals throughout this paper.

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### Structure of this Consultation

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- 1.23** This paper is divided into three sections.
- In the first section we start with who should pay when firms that owe money to consumers fail. We then look at how the current funding arrangements work.
  - In the second section, we ask for views on a number of potential changes. Once we have considered responses to this part of the paper, we will need to consult next year on any specific proposals that we wish to introduce.
  - In the third section, we are consulting on specific rule changes (as set out in Appendix 1). These changes include introducing coverage for debt management firms and extending coverage in respect of fund management and structured deposit intermediation. Once we have considered responses to this part of the paper, we plan to make the resulting changes to our rules next year.

## Section 1

# Who pays? The context for this review

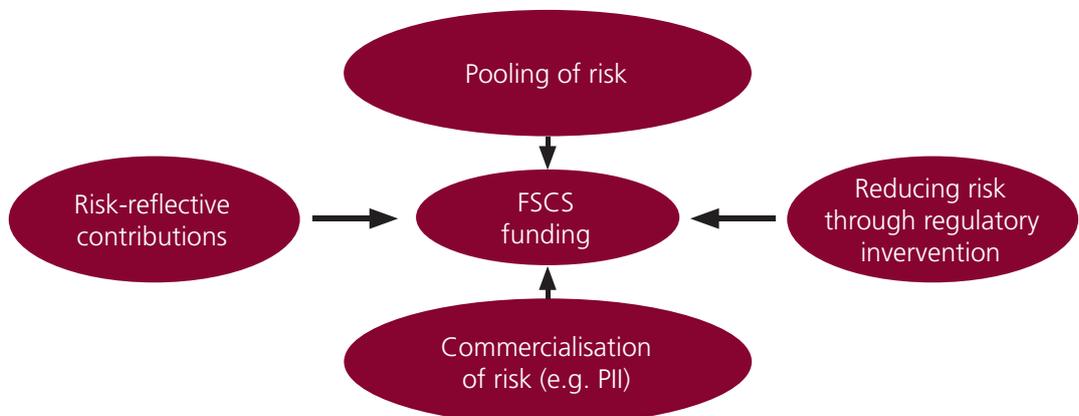
## 2. Compensating consumers: who pays?

- 2.1 The FSCS can step in when an authorised financial services firm is, or is likely to be, unable to pay claims against it. Firms leaving the market may be unable to meet claims because they have insufficient capital or because their PII does not provide coverage. This prompts questions about who could or should compensate consumers.
- 2.2 In this chapter we describe the FSCS’s current funding model. We illustrate the scale of the current levies that firms pay and consider why they may be concerned about the volatility of the levies they face. We look at the current arrangements for paying levies – who pays what and why – when it comes to paying compensation through the FSCS.

### FSCS funding in context

- 2.3 When we consider different options for FSCS funding, we have to balance competing factors. In particular, we have to consider the cost of protection for consumers against affordability for the firms which pay for the compensation. So to maintain the current levels of protection, any reduction in the FSCS levies made on one group of firms has to be balanced by an increase in FSCS levies paid by others. We want to explore the trade-offs involved in different approaches to FSCS funding, as well as whether it is possible to reduce the size of the FSCS’s funding requirement in the longer term (see figure 2.1, below). This could potentially be achieved in a number of ways including through more effective use of insurance cover.

**Figure 2.1 – Factors affecting FSCS funding (for any given level of protection provided by the FSCS)**



## The thinking behind the Funding Review

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- 2.4** The FSCS plays a key role in protecting consumers in the UK financial services market. However, when we look at the extent of coverage the FSCS provides and how it is funded, we need to take into account the full range of our objectives. So, for example, we need to consider overall whether markets are working well and the potential impact of FSCS levies in different areas of the market. We have set out the principles behind the funding review, which include reducing levy volatility and reflecting risk where appropriate, in the Executive Summary.
- 2.5** When proposing changes to funding arrangements, we must ensure that there will be sufficient funding to compensate claimants who are entitled to receive compensation under our rules. We need to take account of the desirability of ensuring that the levies on any particular class of firms reflect, as far as possible, the claims that are, or are likely to be, made on that class. We also need to ensure that we do not focus too strongly on a narrow concept of 'affinity' when we develop options for future changes to funding classes.
- 2.6** The term 'affinity' was previously used to indicate that firms in a particular class have characteristics in common, in the types of activities that they carry out and the industry sectors and products they are involved in. Because of this, 'affinity' was one of the FSA's 'design principles' in deciding and explaining which classes paid levies for different types of claims. However, in practice, the need to pool risk and create sustainable funding classes mean a wide range of activities and firm types are currently covered within each individual class.
- 2.7** We also need to ensure that the scheme enables the FSCS to pay valid claims and uses a transparent funding model. Any proposals should meet our strategic objective of ensuring markets work well, and also advance one or more of our operational objectives.<sup>5</sup> We must also have regard to our regulatory principles.<sup>6</sup>
- 2.8** We recognise how important it is for regulation to encourage incentives that help deliver the outcomes that we want to see in society. The FSCS operates alongside other forms of regulatory protection: it should provide a back stop, it should not be the solution that we look to first. For intermediary firms in particular, the front stop should ideally be commercial insurance in the form of PII, much as it is for lawyers and other professions.
- 2.9** While the capital reserves which firms are required to hold can also help them meet the cost of claims, we believe that capital reserves represent a cost to firms which can in some cases act as a barrier to entry and may not be as efficient as PII cover in mitigating risks.<sup>7</sup>
- 2.10** At the same time, through policy, supervisory and enforcement actions, we can reduce the risk of firms creating claims on the FSCS, and so reduce the funding needed for compensation. However, the relationship is potentially complex. For example, any regulatory action we take to stop SIPPs being mis-sold might accelerate firm failures and increase claims to the FSCS in the short term. However, in the longer term it might reduce the burden on the FSCS from future mis-selling that would have otherwise happened and which could cost more where it relates to longer term products.

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<sup>5</sup> See section 1B(1) and (3) of FSMA. Our operational objectives are securing an appropriate degree of protection for consumers (section 1C FSMA), protecting and enhancing the integrity of the UK's financial system (section 1D FSMA) and promoting effective competition in the interests of consumers in the financial services markets (section 1E FSMA).

<sup>6</sup> See section 3B of FSMA.

<sup>7</sup> This is outlined in the Policy Statement Capital resources requirements for Personal Investment Firms [www.fca.org.uk/publication/policy/ps15-28.pdf](http://www.fca.org.uk/publication/policy/ps15-28.pdf)

**2.11** When we discuss potential approaches to regulatory intervention, we take into account the need to minimise any resulting demand on the FSCS, rather than purely seek increased contributions. Similarly, while changes to our requirements for PII could reduce the cost of levies in the longer term, they could also increase PII costs. These types of changes would also have an impact on firms and markets and so would need to be carefully considered.

### Examining the current model

**2.12** The FSCS is funded by the collection of two levies from the financial services industry. The first is a management expenses levy. This covers ‘base costs’, such as fixed running costs, and ‘specific costs’, such as claims handling costs and other expenses related to paying claims. The second is a compensation costs levy which covers actual or expected compensation payments. Compensation costs and specific costs can vary significantly from year to year, depending on the number of firms that fail and the extent of any liabilities that they leave behind.

**2.13** This funding review focuses on levies for compensation costs and specific costs, not base costs. Base costs are not subject to the volatility that affects compensation costs and specific costs, and are funded by levies imposed on all participant firms in proportion to their regulatory costs.<sup>8</sup> Base costs are not funded by levies on the nine funding classes we discuss below, nor can they be covered by the ‘retail pool’. The retail pool is called upon if costs in a particular funding class are so high that firms in other classes need to be called upon to contribute.

### What FSCS funding looks like today

**2.14** Compensation costs and specific costs are funded by levies collected from individual participant firms. The FCA has nine funding classes. Five of these are the principal ‘funding classes’ and the remaining four are only in the retail pool. The PRA has three funding classes.

**Figure 2.2 – List of current FSCS funding classes**

Class	Type of class
<ul style="list-style-type: none"> <li>• deposits</li> <li>• life and pensions provision</li> <li>• general insurance provision</li> </ul>	PRA FSCS funding classes
<ul style="list-style-type: none"> <li>• Class D1 investment provision</li> <li>• Class C2 life and pensions intermediation</li> <li>• Class E2 home finance intermediation</li> <li>• Class D2 investment intermediation</li> <li>• Class B2 general insurance intermediation</li> </ul>	FCA FSCS funding classes
<ul style="list-style-type: none"> <li>• Class F deposit acceptor’s contribution</li> <li>• Class G insurers – life contribution</li> <li>• Class H insurers – general contribution</li> <li>• Class I home finance providers and administrators’ contribution</li> </ul>	FCA provider contribution classes (retail pool only. The ‘retail pool’ is the total amount that can be raised for FCA classes once the class threshold has been breached. Once the FCA class thresholds are breached other classes contribute to the costs of a failure. The amount available depends on which funding class has failed.)

<sup>8</sup> *Financial Services Compensation Scheme Levy Calculation Notes, 2016/17 Rates*, [www.fca.org.uk/publication/fees-information/fscs-levy-calculation-notes-16-17-rates.pdf](http://www.fca.org.uk/publication/fees-information/fscs-levy-calculation-notes-16-17-rates.pdf)

- 2.15** A participant firm's permissions determine which class, or classes, it belongs to. If a firm is a member of more than one funding class, the total compensation costs and specific costs levy for that firm in a particular year is the sum of the individual levies calculated for each class the firm belongs to. So, if a firm is in a funding class and also in an FCA provider contribution class, its total compensation costs and specific costs levies in a particular year will combine the levies for both the funding class it is in plus any levies imposed on the provider contribution class.
- 2.16** A firm's compensation costs levy or specific costs levy in one of the five FCA funding classes is proportionate to the size of its annual eligible income and the amount of FSCS compensation that its individual funding class will have to pay. Each class has a levy limit or 'threshold'. This is the maximum amount of costs which can be allocated to that particular class in a financial year. Using the threshold for a particular funding class, along with historic information about the firms in the class and amount of eligible income that they may generate, we can calculate the maximum percentage of eligible income that could be collected to pay a levy in a given year.
- 2.17** For intermediation activities, in 2015/16 the current thresholds represented between 3.2% and 3.6% of intermediary firms' eligible income, as the table below illustrates. In practice, this means that firms in each of those funding classes would have been asked to pay up to, but no more than, the 'implied threshold' percentage on their eligible income (see the right hand column of the table).

**Figure 2.3 – Comparison of income paid under the current classes**

<b>Class</b>	<b>Threshold</b>	<b>Eligible Income 2015/16</b>	<b>Implied threshold 2015/16</b>
General Insurance Intermediation	£300m	£8,918m	3.4%
Life and Pensions Intermediation	£100m	£3,158m	3.2%
Investment Intermediation	£150m	£4,169m	3.6%
Home Finance Intermediation	£40m	£1,172m	3.4%

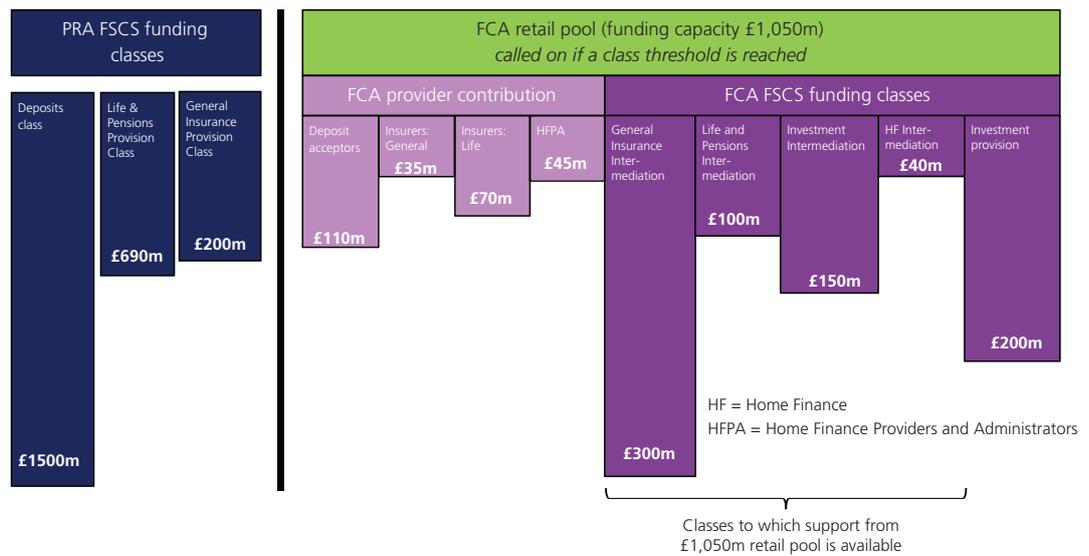
### **Retail Pool**

- 2.18** Each of the five FCA funding classes has a threshold to try to ensure that firms' contributions to the FSCS are affordable and sustainable. If compensation and specific costs in a funding class are so high that the threshold is breached, firms in other classes are called upon. Therefore, compensation costs and specific costs for the intermediation classes and the investment provision class which exceed their class thresholds may be allocated to the retail pool.
- 2.19** The retail pool consists of all nine classes: that is, the five FCA funding classes plus the four FCA provider contribution (retail pool-only) classes. Levies for compensation or specific costs that are allocated to the retail pool because a funding class has exceeded its threshold are distributed across the other funding classes, together with the FCA provider contribution classes (classes F, G, H and I in figure 2.2), but only up to their respective class thresholds. If those thresholds are breached, then the FSCS would use its commercial borrowing facility and, if the funding was needed, it could apply for funding from the National Loans Fund. The FCA provider contribution classes may contribute to levies funded by the retail pool for claims against the intermediary classes (but not the investment provision class), and cannot receive any of this funding themselves. The FCA provider contribution classes also have a different levy

calculation to the five FCA funding classes, based on regulatory costs instead of annual eligible income.

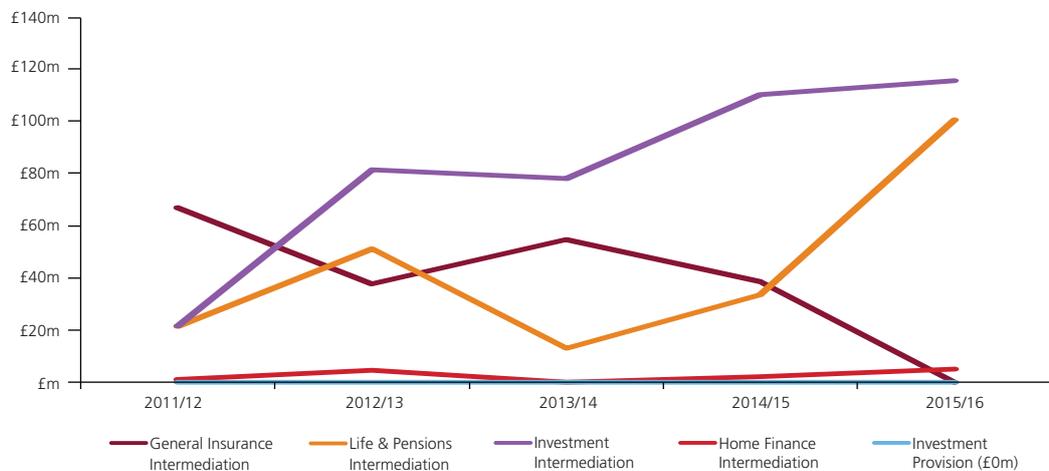
**2.20** The diagram below sets out the classes, the class thresholds and how the relevant classes support the retail pool.

**Figure 2.4 – Current FSCS funding model<sup>9</sup>**



**2.21** **Looking at the levies collected in practice** Under the current funding model, each firm contributes to the FSCS funding classes that match the services it provides. The diagram below shows recent trends in the FSCS levies paid by intermediaries and investment providers. In particular, it demonstrates the wide variation in the levies paid by three of the four intermediation classes.

**Figure 2.5 – Recent trends in the FSCS levies**



9 As included in the FSA's PS13/4 FSCS funding model review – feedback on CP13/1 (March 2013).

- 2.22** Increases in levies on particular funding classes were due both to significant failures of individual firms, such as Alpari (UK) Ltd<sup>10</sup> and Catalyst Investment Group Ltd<sup>11</sup> (in the Investment Intermediation class) and increases in claims across a number of failed intermediary firms, such as for the misselling of SIPP investments (in the Life & Pensions Intermediation class). Similarly, the reduction in levies paid by the General Insurance Intermediation class in recent years reflects, at least partly, the declining number of Payment Protection Insurance (PPI) claims.
- 2.23** These major individual firm and specific product-related failures were the main reason that firms' levies varied so much. In some cases, individual failures lead to questions about whether all firms within a particular class should pay for the compensation costs incurred by a minority of firms, with which they may feel little affinity. While FAMR focused on financial advice firms, it concluded that we should consider how we can redesign the funding arrangements, without reducing consumer protection, to better spread the FSCS levy among firms in the intermediation funding classes. We discuss this in Section 2 of this CP.

### Who can claim from and who should contribute to the FSCS?

- 2.24** The FSCS does not compensate every consumer who suffers a loss. Consumers who buy investments, for example, must be prepared to take on the risk that their investment may perform badly. The FSCS steps in where a firm is, or is likely to be, unable to pay claims against it but owes a 'civil liability' to a claimant. Equally, firms currently only contribute to FSCS funding if they have permission to carry out activities which the FSCS covers and they earn income from those activities – known as 'eligible income'.
- 2.25** Our rules set out the types of claim that are protected, which enables the FSCS to determine which claims are 'protected claims'. We describe the people who can claim on the FSCS as 'eligible claimants' and, historically, most claims have been from individuals. Eligible claimants include individuals, businesses, charities and trusts, depending on the type of claim.<sup>12</sup> We look in more detail at the types of activities for which FSCS protection should be available in Section 2.

### Understanding the role of civil liability

- 2.26** One of the conditions of our rules that must be met before the FSCS can pay compensation is that the claimant has a valid civil claim (of a protected type) against a 'relevant person' who is no longer in business. In broad terms, a 'relevant person' means an authorised person or an appointed representative<sup>13</sup> or a successor firm that has taken on the responsibilities of the relevant person. A valid civil claim can be made for a number of reasons, including where there is a breach of contract or statutory duty or negligence by the relevant person. We discuss this further in Section 3.

### Eligible income in practice

- 2.27** The FSCS is currently funded through the collection of the base costs, specific costs and compensation costs levies. The amounts that participant firms must pay are calculated on a proportional basis. A firm's contribution to the base costs levy is calculated by using the individual firm's regulatory costs to decide their proportion of the total regulatory costs<sup>14</sup> that firms in the same activity group must pay. Compensation costs and specific costs are calculated

<sup>10</sup> Information is available at [www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-alpari-uk-limited/](http://www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-alpari-uk-limited/)

<sup>11</sup> Information is available at [www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-arm-and-catalys-j847tta1d/](http://www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-arm-and-catalys-j847tta1d/)

<sup>12</sup> See Compensation Sourcebook (COMP) 4.2 for further details ([www.handbook.fca.org.uk/handbook/COMP/](http://www.handbook.fca.org.uk/handbook/COMP/))

<sup>13</sup> See sections 213(9) and (10) of FSMA.

<sup>14</sup> A firm's regulatory fees are calculated in accordance with FEES 4 Annex 1AR.

by using annual eligible income, which is a measure of the firm's income from activities within a funding class. Eligible income can include commissions, brokerages and fees. It can be restricted to compensatable income from the firm's relevant business, rather than all income from all activity the firm undertakes within the class. Individual firms must calculate and report their eligible income to the FSCS each year.

### Approaches to funding

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**2.28** The FSCS can only charge firms the amount of levy they know or expect will be needed to meet actual expenses and assess and pay compensation under the scheme. The FSCS must also be able to have the funds to pay claims when the claims fall due. Currently, the FSCS cannot impose levies to meet expenses that it cannot reasonably anticipate. As a result, it is not able to build up any reserve for future claims, ie it cannot 'pre-fund'. While the FSCS attempts to accurately forecast future compensation costs,<sup>15 16</sup> it is impossible to predict accurately how much it will have to pay out each year. Below, we look at some of the different types of funding models that have been suggested to reduce the variation in levies that firms pay.

#### Pre-funding vs. pay-as-you-go

**2.29** Under the current system, levies are raised each year based on known or anticipated claims. The FSCS might be able to reduce the volatility of levies if it could accumulate a surplus fund over time to pre-fund future compensation payments.

**2.30** While a pre-funded system is potentially attractive, moving to this system presents a number of challenges. First, the fund would have to be built up. To achieve this, the FSCS would have to collect significantly higher levies for a shorter period of time, or slightly higher levies for a longer period. While it is difficult to quantify precisely what this would cost firms, in basic terms this could mean a doubling of the levy for a year, an additional 50% of the levy for two years and so on. It is not clear that firms would be willing to pay these higher levies to secure greater future predictability. In addition, new entrants to the market would benefit from reduced levies because of funds accumulated before they joined. A further obstacle would be the need for legislation to enable pre-funding.

**2.31** Finally, we would need to be able to answer questions about the treatment of firms entering and leaving the market, including whether they would face 'entrance levies' and 'exit levies'. We believe that these practical obstacles are significant barriers to introducing pre-funding and therefore we do not intend to pursue this option.

#### Examining the case for a product sales levy

**2.32** A related idea would be to use a levy on product sales to fund the FSCS. Some of the stakeholders who have suggested this gave the example of insurance premium tax to illustrate how it could work.

**2.33** From a practical perspective, administering a product levy or sales tax would seem to require pre-funding and involve the same challenges. This is because there is no evidence that collecting a pre-determined percentage of the product price would provide only the necessary amount of funding each year. It may provide more than is needed in that year. In addition, a product sales levy is a tax issue and falls outside the remit of this review.

<sup>15</sup> Under FEES 6.3.1R, the FSCS calculates compensation costs by considering expected claims for the 12 month period following the date of the levy or, if higher, one third of the costs expected in the 36 month period following the date of the levy.

<sup>16</sup> See the section on 'Extending the period over which the levy is calculated' in Chapter 6 of FSA CP12/16 (July 2012) for further details.

**2.34** However, the idea of a product sales levy reflects many firms' belief that product providers should play a key role in contributing to the FSCS or, at least, price their products to take account of the need for FSCS funding. Support for this idea may be at least partly based on a desire for product providers to have incentives to design products that are both well-understood by intermediaries and that benefit end consumers.

**2.35** We considered this carefully. We understand the desire to increase the role of product providers and create a clearer link between products manufactured and FSCS claims, even where these products are advised on or distributed by third-parties. Although we are not proposing to introduce an actual product levy, we are considering whether we could more clearly link product risk to levies and whether product providers should contribute to claims involving intermediaries.

### **How should the cost burden be shared?**

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**2.36** Overall, we tend to think of financial services firms as benefiting from the FSCS because it gives consumers the confidence to engage with the industry. What is less straightforward is deciding precisely how much any given firm should contribute.

#### **'Affinity' and risk in practice**

**2.37** The levies imposed on any particular class of firms should reflect the claims made against that class as much as practically possible. So we need to think carefully about the nature of the classes into which firms' activities are divided – and what 'affinity' between firms really means. In practice:

- Many large and small firms are grouped together for FSCS funding purposes because they all carry out investment intermediation in some form.
- Some stakeholders want us to consider further sub-dividing some of the current funding classes. While this may be appealing as a way to try to increase the similarities between firms that are grouped together, it would not necessarily create sustainable funding classes or reduce levy volatility.
- Individual firms would still be dissatisfied where compensation claims result from poor practice by firms that deviates from their own practices and standards.

**2.38** As part of reassessing the concept of affinity, we want to find out if it is possible to identify factors that increase the risk that a firm poses to the FSCS. As suggested by FAMR, this CP looks further at whether we can and should introduce risk-based levies. However, we also need to ask important questions about whether it is possible to objectively identify firms that pose a higher risk of generating future FSCS claims.

#### **Product providers and intermediaries**

**2.39** We have already raised the question of how the relative responsibilities of providers and distributors are reflected in FSCS funding. Currently, product providers and distributors do not share the burden of FSCS levies equally. Figure 2.5 earlier in this chapter indicates that levies faced by firms in the investment intermediation class reached £116m in 2015/16, while firms in the investment provision class have not had to contribute to any significant compensation costs in recent years.

- 2.40** Differences in the scale of claims against firms in different funding classes are reflected in differences in contribution patterns and failures between product providers and intermediaries. However, funding arrangements can better reflect the affinity between product providers and the firms that distribute their products. In reviewing the current funding arrangements, we need to consider the risks and responsibilities of different firms when it comes to the distribution of products. So this CP looks at whether product providers should play a greater role in FSCS funding.

### Forecasting claims and setting levies in practice

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- 2.41** In 2013 the FSA amended the rules on how the FSCS levy is calculated.<sup>17</sup> Under the revised rules, the maximum expected compensation costs they could include in the annual levy was set as the greater of: a) costs anticipated in the twelve months from the date of the levy and b) one-third of the three-year aggregate.<sup>18</sup>
- 2.42** For example, if the FSCS calculated that total compensation costs for a particular class were likely to be £120m over the next three years, it could include £40m anticipated compensation costs in the next annual levy for that class. While these changes gave the FSCS freedom to predict and prepare for expected claims, they also gave it the difficult challenge of accurately forecasting the scale of future claims. We want to ensure that the FSCS keeps the flexibility it needs to anticipate and spread known costs but we also want to address the problem of both unexpectedly and consistently high levies.
- 2.43** With this in mind, we open up discussion of various options in Section 2 and seek your views on different options for tackling volatility, spreading costs and revising the FSCS funding classes.

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<sup>17</sup> CP13/1 *FSCS Funding Model Review – feedback on CP12/16 and further consultation* (January 2013)

<sup>18</sup> FEES 6.3.1R(3)

### 3. Professional Indemnity Insurance: is it working?

- 3.1** PII and regulatory capital requirements can affect the likelihood of a firm being able to meet claims against it. If a firm does exit the market, its PII policy and its capital position will decide the extent of any claims that will fall on the FSCS.
- 3.2** The actual minimum amount and form of regulatory capital that an individual firm is required to hold will vary considerably depending on a range of different factors, particularly the regulated activities the firm is permitted to undertake. In some cases a firm will be bound by a flat minimum capital requirement, while in others the requirement will also be risk-based or increase with the size of the firm.
- 3.3** The detail on capital requirements may be found in different sourcebooks across our Handbook and in some cases directly in EU legislation. Some types of firm will currently be required to hold considerably more regulatory capital to absorb losses, and meet claims against them, than others. However, we believe that capital requirements operate quite differently depending on the nature of the firm. Banks can make use of capital reserves as funding, allowing the risk to be intermediated across their balance sheets. This is different from intermediary firms authorised by the FCA, which do not use capital to fund a balance sheet and have to invest it instead, meaning that those firms have to take on more risk. With this distinction in mind, we are not currently proposing to pursue further capital requirements as an approach for intermediary firms.<sup>19</sup>
- 3.4** In this chapter we consider how the PII market interacts with the FSCS. We look at the reasons why a firm's insurance policy may fail to pay out and leave the FSCS liable or unable to recover compensation payments from the PI insurer. We also look at whether altering a firm's PII could reduce claims on the FSCS.

#### Reviewing the PII market and our requirements on PII cover

- 3.5** The FAMR report recommended that, following our review of FSCS funding and given the evidence of the impact of the PII market on FSCS funding, we should consider whether to undertake a further review of the availability of PII cover for PIFs.<sup>20</sup> In particular, the report recommended that we should look at this in the area of small advisory firms. In Section 2, we open up discussion to gather further evidence and views on how we should approach PII. We

<sup>19</sup> For further discussion and explanation of our prudential requirements for PIFs, see CP15/17, *Capital resources requirements for Personal Investment Firms (PIFs)* (May 2015) and PS15/28, *Capital resources requirements for personal investment firms (PIFs): feedback on CP15/17 and final rules* (December 2015).

<sup>20</sup> In general, we mean firms for which the majority of their income is from advising on or arranging deals in packaged products for retail clients. The definition of a personal investment firm is set out in further detail in our Handbook Glossary ([www.handbook.fca.org.uk/handbook/glossary](http://www.handbook.fca.org.uk/handbook/glossary)).

want to find out if it is possible to target a reduction in the size of the funding required by the FSCS over the medium term.

- 3.6** We currently require PIFs to take out adequate insurance cover or a comparable guarantee from a bank, building society or insurer.<sup>21</sup> This cover should take into account the effect that the insurance policy's terms might have on the firm, and firms must report their policy details to us as part of the Retail Mediation Activities Return (RMAR).<sup>22</sup> A firm must ensure it has continuous cover from the date it is authorised.
- 3.7** PII is currently sold on a 'claims made' basis. This means that the insurer whose policy is in force at the time any claim is made by the firm is responsible for meeting that claim.

### Understanding the PII market in practice

- 3.8** There are few PII providers active in the PIF market, usually around ten to fifteen firms at any one time, although there have been some recent entrants. This is a relatively self-contained and specialist area of insurance. It typically requires a high degree of underwriting experience and knowledge, with providers competing for a limited amount of available premiums. While the PII market as a whole generates annual premiums of perhaps £1.8bn, only around £50m of this is from financial advisers.<sup>23</sup>
- 3.9** The small size of the market also means that it can be especially vulnerable to wider fluctuations in market conditions, such as interest rate changes, equity market volatility and the overall availability and price of insurance (the 'underwriting cycle'). This means that, when markets harden and there is less profit to be made, PII may not be a first choice for larger insurance groups deciding where to allocate capital. Therefore, we need to be aware of the potential impact on the market when proposing any changes to insurance requirements. However, there are a number of indications that PII is not functioning as effectively as it should and we wish to address these.
- 3.10** First, some PIFs have told us that they find it difficult to purchase PII cover that is appropriate to their needs and, in some cases, they have been unable to find PII cover at all. The absolute requirement to have insurance creates the risk that firms will settle for purchasing policies which may not be adequate for their needs and that price is artificially inflated. Nonetheless, we believe it is important to strike the right balance between the availability of insurance and its effectiveness. Ultimately, this means that the cost of protecting consumers will fall more heavily on the firms which deal directly with those consumers, rather than on all other firms in the industry, even if this means that some firms may find it harder to enter or stay in the market.
- 3.11** Second, the FSCS and other industry stakeholders have given us evidence that not all PII policies respond adequately to claims made on them. A particular concern is that some policies exclude the insolvency of the policyholder (the PIF) or the FSCS as a claimant. This prevents the FSCS reclaiming from the insurer the cost of any compensation it might already have paid out. As a result, the cost of this liability falls on the FSCS. The fact that the FSCS ends up paying instead of the insurer may be a relatively small concern for a firm facing insolvency, but this cost is

<sup>21</sup> The Insurance Mediation Directive (IMD) sets additional requirements for minimum aggregate levels of cover for firms with higher income.

<sup>22</sup> See IPRU-INV 13: Financial Resource Requirements for Personal Investment Firms.

<sup>23</sup> Estimates from Professionalindemnity.co.uk ([www.professionalindemnity.co.uk/professional-indemnity-insurance-market-information.html](http://www.professionalindemnity.co.uk/professional-indemnity-insurance-market-information.html))

ultimately borne by the industry as a whole. Spreading the risk across all firms does not follow the principle that the 'polluter pays'.

- 3.12** Additionally, PII policies may also exclude particular types of sales and advice from their cover. Alternatively, policies without such exclusions or high excesses may have higher premiums, which insurers calculate by using the percentages of relevant business the firm undertakes.
- 3.13** When firms follow our requirements for additional capital, their ability to meet claims, either through capital or insurance should be unaffected. Nonetheless, the evidence shows that some firms remain unable to meet their liabilities and subsequently consumers end up calling on the FSCS.
- 3.14** We need to recognise why this happens. From the perspective of insurers, it can be especially hard to price the risks inherent in the financial advice market. Many firms and their insurers point to difficulties in anticipating future liabilities and the types of advice or products which might give rise to claims. As new products emerge, it can take time to evaluate their regulatory impact and how any future claims might be treated by the Financial Ombudsman Service, or by the FSCS, given the two organisations' different mandates. Unsurprisingly, the PII market can also be affected by concerns about possible future regulatory actions. In the past, we have also seen the market hardening following major mis-selling events or the start of regulatory discovery work.
- 3.15** Where insurance policies include notification requirements for the policyholder, an insurer may reject claims if the firm has not notified its insurer about upcoming liabilities in the correct way.
- 3.16** These factors mean it can be difficult for underwriters to find reliable risk factors, leading them to rely largely on the previous claims histories of firms and individuals, although they may also take into account a wide variety of other business features when developing a risk profile. Yet we know from our own data that complaints or claims history is a relatively weak predictor both of future claims and of a firm being declared in default by the FSCS.
- 3.17** Insurers reflect this uncertainty in the premiums they charge and through policy excesses. However, they also reflect this uncertainty by excluding from cover particular types of mis-selling or products which they know to be higher risk. Product exclusions help insurers to avoid more costly claims, but they can leave PIFs unprotected should they choose to provide certain types of advice. Insurers may also be likely to amend the terms of cover when a firm renews a policy after a claim has been made, to exclude further claims about the same type of product or advice. To this extent, PII can be seen as a one-off form of protection, rather than an ongoing and reliable protection against any future liabilities. Therefore, we need to recognise any inherent limitations of PII cover when we propose any new requirements. We also need to be mindful of the possible impact of changing how PII operates on firms' business models and competition, including how new entrants to the market might be able to obtain insurance cover at an acceptable price.
- 3.18** In Section 2 of this paper, we outline possible ideas and options for the PII market and ask for your views.

## Section 2

# Ideas and options for discussion

## 4. Risks and responsibilities

- 4.1** In this chapter we consider how we can reflect both the risks from firms' activities and the responsibilities that firms owe to each other as we review FSCS funding. We look at and open up for discussion the challenges of introducing a risk-based FSCS levy. In the second half of the chapter we discuss the case for introducing product provider contributions towards the compensation paid when intermediary firms fail.
- 4.2** Please also see the separate chapter on risks and responsibilities: reporting requirements, in Section 3, for our specific proposals on data collection, which could become the first step towards the introduction of a more risk-based approach.

### Exploring what affects the risk of a FSCS claim

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- 4.3** We understand that some firms are concerned about being made to contribute to the FSCS on the same basis as peers who undertake different – and in some cases much riskier – types of business. So we are exploring the idea of a risk-based levy system. To do this, we start with the question of how we can identify 'riskier' firms – or, more specifically, those firms at greater risk of failing and leaving significant liabilities for the FSCS.

### Capital, complaints and other firm-specific risk factors

- 4.4** Using historic data, we considered the relationship between FSCS claims and six firm-specific risk factors:
- a firm's leverage ratio<sup>24</sup>
  - a firm's liquidity ratios<sup>25</sup>
  - the return a firm receives on assets
  - the amount of capital a firm holds
  - the ratio of excess capital to revenue, and
  - complaints data

The purpose of our analysis was to identify specific characteristics that could increase the likelihood of a firm defaulting and leaving significant liabilities for the FSCS.

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<sup>24</sup> Leverage ratio, defined as total capital and reserves to total assets ratio.

<sup>25</sup> Liquidity ratio, defined as total current assets to total assets ratio.

**4.5** Our analysis is set out in detail in Annex 3, and further detail is available on request. We made some interesting, if not particularly surprising, observations. For example, a 100% increase in a firm's liquidity ratio is linked to a reduced likelihood of it exiting the market by 21% and a firm with double the FCA complaints compared to its peers was 10% more likely to exit the market. But, overall, our testing found little conclusive evidence that any of the six firm-specific risk indicators could accurately predict future FSCS claims. In looking at the data, we also recognise that in many cases, a firm can and will exit the market without generating an FSCS claim.

**4.6** We do not believe that any of the metrics listed above are suitable to include in any measure used to set FSCS levies. We recognise that the basis of the relationship between FSCS claims and any of these factors would change if any of these factors were incorporated into the levies, in advance of any claim. We would like your views on our analysis. In particular, we would like your comments on the longer-term value of applying a more sophisticated risk metric.

#### **Higher-risk retail investment products**

**4.7** We explored whether there was a relationship between FSCS claims and the distribution of specific investment products. Our analysis showed that, between 2013 and 2016, a third of the value of all FSCS claims was linked with the sale of non-mainstream pooled investments (NMPs) by the regulated advice sector. NMPs are pooled investments or funds characterised by unusual, speculative or complex assets, product structures, investment strategies and/or terms and features. They include:

- units in unregulated collective investment schemes (UCIS)
- securities issued by some special purpose vehicles (SPVs)
- units in qualified investor schemes (QISs), and
- traded life policy investments (TLPs)

**4.8** Our past supervisory work found that one in four NMPs were mis-sold. As a result, in 2013 we introduced restrictions prohibiting FCA authorised firms from promoting NMPI products to ordinary retail customers.<sup>26</sup> Since then, we have taken further steps to tackle the problems posed by NMPs. In August 2016, we issued an alert to investment advisers reminding them of their responsibilities when giving consumers advice about unregulated and other higher risk investment products.<sup>27</sup> In September 2016, we introduced higher capital requirements for SIPP operators accepting non-standard assets such as NMPs.<sup>28</sup>

**4.9** While many intermediary firms that distribute NMPs will do so responsibly, those that do not may pose a higher risk of defaulting and creating significant liabilities for the FSCS. Although it is hard to predict which firms are most likely to trigger significant FSCS claims, we are interested in the relationship between past FSCS claims and NMPs and we intend to investigate this further.

<sup>26</sup> COBS 4.12 Restrictions on the promotion of non-mainstream pooled investments.

<sup>27</sup> FCA Alert: *Investment advisers' and authorised firms' responsibilities when accepting business from unauthorised introducers or lead generators* (August 2016).

<sup>28</sup> Personal Pension Scheme Operators (Capital Requirements) (Amendment) Instrument 2015 (FCA 2015/58).

## Preparing to introduce a risk-based levy

### Introducing risk premiums or discounts

- 4.10** Given the potential association between FSCS claims and firms' involvement with certain products, we are considering whether firms should pay a premium on FSCS levies (ie they would pay a higher levy) if they distribute products that we consider to be 'higher risk'. These could be products that have been linked to past FSCS claims. So they could include investment products that FCA authorised firms are currently prohibited from selling to ordinary retail customers. While they are already the subject of our retail distribution restrictions, it may also be appropriate to consider introducing higher FSCS levies for firms involved in their distribution.
- 4.11** In the future, firms could be expected to cover a greater share of the FSCS levies if a significant part of their income comes from the sale of high risk products and/or high risk activities. Or, conversely, firms could be eligible for a discount if their behaviour reduces risk. Our aim would be for a greater proportion of the cost of the FSCS to be borne by those firms most likely to incur it.
- 4.12** A premium could target intermediary firms that distribute investment products which are already subject to restrictions, such as:
- NMPIs
  - contingent convertible instruments (CoCos) and CoCo funds
  - mutual society shares,<sup>29</sup> and
  - non-readily realisable securities
- 4.13** Not all intermediary firms will hold the relevant permissions to distribute all of these products. For this reason, a premium would only apply to affected firms that conduct investment intermediation or life and pensions intermediation. It would not apply to firms whose sole business is non-investment insurance business, pure protection business or home finance intermediation business or any combination of these three.
- 4.14** While we are not yet consulting on rules to introduce a risk premium into FSCS funding in this paper, we have considered how such a premium might work. Any premium collected would affect how annual levy costs are allocated across intermediary firms. Firms that choose not to undertake any business involving 'higher risk' investment products would be allocated a reduced share of the annual levy for their class, compared to firms that do.
- 4.15** It seems likely that the cost of any premium, to some degree, would be passed through to the consumer, leaving each firm to make a commercial decision about whether it should continue to provide higher risk products. However, it is difficult to test what the full impact of a risk-based premium would be without collecting additional data from firms. Currently, we do not require intermediary firms to report how much of their eligible income comes from selling higher risk investment products. For this reason, we do not intend to consult on introducing a risk premium until we have collected and examined additional data from intermediary firms (see chapter 10 for our proposals in detail).

<sup>29</sup> For further details see FCA PS15/14: *Restrictions on the retail distribution of regulatory capital instruments* (June 2015).

### **Unrated insurers**

- 4.16** Recent insurance firm failures suggest that unrated insurers have a higher likelihood of failing than rated insurers. The recent failures of unrated insurers such as Enterprise, a Gibraltar based insurer, left a significant number of customers with financial losses. In some circumstances, these customers have been able to receive protection from the FSCS under PRA rules.
- 4.17** Given the level of risk associated with placing customers with unrated insurers, we are considering whether brokers that place business with them should pay a higher levy than brokers who only deal with rated insurers. The rationale for this would be similar to that for introducing a premium for higher risk investment products.

**Q1: Do you agree with the introduction of risk-based levies? Should we also consider other regulatory responses?**

**Q2: Do you believe that risk-based levies could be appropriate in relation to: a) higher risk investment products; b) insurance brokers that choose to place business with unrated insurers; and c) any other types of specific products or services?**

### **Responsibilities of product providers**

- 4.18** The links between product providers and the firms that advise on or distribute their products are potentially complex. But in recent years, various FSCS cases have prompted scrutiny of the relative roles and responsibilities of product providers and distributors in the supply chain. There has, for example, been debate about the responsibilities of different firms following the failure of Arch Cru.<sup>30</sup> These cases may be one of the reasons that some firms have called for product providers to increase their contribution to FSCS funding through a product levy or tax. These firms may also believe that providers are at least partly responsible for the losses that lead to FSCS claims.
- 4.19** We recognise that the burden of funding the FSCS does not fall equally upon product providers and distributors, as they are in different classes. These issues are central to firms' responsibilities for product governance, and we have outlined our expectations of product providers in previously published guidance.<sup>31</sup> Firms that provide products will also contribute to intermediation classes for the intermediation activities that they themselves conduct.
- 4.20** These contribution patterns may be appropriate because they reflect the differences in the number of failures and the scale of claims on the FSCS of these different classes. However, we believe it is important to consider whether and how the relative responsibilities of providers and distributors are reflected in FSCS funding, in line with our work on product governance.

### **Product governance**

- 4.21** At present, FSCS funding allocates firms' activities into different funding classes depending on whether they involve manufacturing or distributing different products and services or both. But this approach does not account directly for the affinity and interdependence between product providers and the firms that distribute their products. Nor does it consider the risks and responsibilities of different firms in the value chain when it comes to distributing products.

<sup>30</sup> Information is available at [www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-cf-arch-cru/](http://www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-cf-arch-cru/)

<sup>31</sup> The Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD) [www.handbook.fca.org.uk/handbook/document/RPPD\\_FCA\\_20130401.pdf](http://www.handbook.fca.org.uk/handbook/document/RPPD_FCA_20130401.pdf)

**4.22** As well as setting out our expectations in this area in the Responsibilities of Providers and Distributors for the Fair Treatment of Customers (RPPD), product governance matters are covered in European legislation. The new Markets in Financial Instruments Directive (MiFID II) and the Insurance Distribution Directive (IDD) apply responsibilities to firms that manufacture or sell products to ensure that firms understand the nature of the products and sell them to suitable clients.

#### **Product provider support**

**4.23** We have considered the role that authorised product providers play in the market and propose a change to their funding requirements. Currently, authorised product providers only contribute to the costs of failed intermediaries from levies they pay for their own intermediation activities within the intermediation funding classes, and also to any costs incurred if the retail pool is triggered. Bearing in mind firms' product governance responsibilities and the burden that has fallen on intermediary firms in recent years in funding the FSCS, we believe it is appropriate that providers pay additional contributions.

**4.24** In Chapter 7, we look at various possible funding class structures involving provider contributions towards intermediary classes. These contributions could come from:

- general insurers
- life insurers
- home finance providers and administrators
- investment providers, and
- deposit acceptors (if, as we propose in Section 3, FSCS coverage is extended for structured deposits)

**4.25** In each case, we will look at including contributions to intermediation classes from the provider classes. In contrast to the current arrangements, product providers could potentially contribute from the first pound of any claim facing intermediaries up to relevant limits.

**4.26** Of course, it remains important to ensure that product providers' contributions to the FSCS are both affordable and sustainable, but we believe this is compatible with our proposals. Introducing product provider contributions would ensure that the FSCS has a robust funding model, with sustainable classes that provide sufficient funding for compensation.

**Q3: Do you agree in principle that product providers should contribute towards FSCS funding relating to claims caused by intermediary defaults?**

## 5. Professional Indemnity Insurance: options for change

- 5.1** In this chapter, we set out a range of different ideas and options for discussion, in respect of our approach to regulating the PII market. We outline our view that there is a case for strengthening the PII cover of PIFs in particular. We ask questions about the impact and effectiveness of PII cover and the possibility of requiring more comprehensive insurance.

### Our approach to the PII market

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- 5.2** It is important to remember that the FSCS should never be considered the first solution, but rather a back stop when other protections have failed. In cases where firms' systems and controls fail to prevent detriment, we believe that PII should provide a front stop to either prevent the firm's failure from occurring or the consumer detriment that could result from it.
- 5.3** Our analysis so far shows there is justification for strengthening PII, particularly for PIFs, for example through the use of mandatory terms. Our focus on PIFs (including financial advisers and other intermediaries) reflects the scale of claims made in the investment intermediation and life and pensions intermediation classes in the past five years (as illustrated in figure 2.5). We are using this paper to gather further evidence and views before undertaking a detailed review of available data and evidence during 2017. Depending on the outcome we may consult on draft rules.
- 5.4** If we introduced rules to tighten the specific level of cover required from PII policies, PI insurers would cover some of the claims that would otherwise be paid by the FSCS. Tightening rules could also prompt firms to stop riskier practices in order to get cover or to pay less for it. While we already have rules on the PII firms should hold, we will consider whether it may be necessary to consult on further amendments at a later date, to make our rules more explicit and comprehensive.
- 5.5** The key focus of this discussion is insurance that covers investment advice, where we often see the highest numbers of FSCS claims. We also welcome your views on other areas of PII, such as insurance for mortgage and insurance intermediaries.<sup>32</sup> If we decide to propose any rule changes, we will consider further how best to make those consistent across different types of firm.

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<sup>32</sup> The PII requirements for these firms are set out in MIPRU chapter 3. We have recently reviewed firms' compliance and included the results in: FCA Review of general insurance intermediaries' professional indemnity insurance: Report on the thematic project (December 2016).

## Our current capital and PII requirements

- 5.6** We do not currently specify the standard terms which must be included in PII policies. However, we do require minimum levels of indemnity cover, both for single and multiple claims. The Insurance Mediation Directive (IMD) sets indemnity limits for insurance intermediation work, as well as additional requirements for minimum aggregate levels of cover for firms with higher income. PIFs can buy PII policies which exclude particular types of business, but only if they meet our additional capital resources requirements which are based on a firm's income.<sup>33</sup> Policies must not include a claims excess level of more than £5,000, unless the firm holds additional capital resources.<sup>34</sup>
- 5.7** It is important to match a firm's capital resources with the terms of its PII cover to reduce both the numbers of firms calling on the FSCS and the cost burden of the FSCS on the industry as a whole. One aspect of this is policy excess levels; the amount which policyholders themselves have to absorb before an insurance policy pays out. Our rules require PII policies to include a claims excess level of no more than £5,000, unless the firm holds additional capital resources. In practice, a firm may well have a policy excess of £20,000 or more. In these cases, if it maintains its required capital reserves, it should have the funds to meet claims which are below the excess limit. On the other hand, if the firm knows it is likely to receive multiple future claims it will struggle to meet, we have found that firms sometimes run down their capital reserves, meaning the combined protection of insurance and capital resources may no longer be sufficient, leaving the FSCS to pay any claim.
- 5.8** We have to use our finite resources proportionately, including when assessing and supervising firms' compliance with capital resource requirements. With this in mind, we have considered whether to change mandatory insurance excess levels (ie reducing the scope for large excesses). Clearly, some degree of FCA monitoring would be required, either of the policyholders or potentially of the relevant insurers and/or brokers. We will consider the relationship between capital resources and PII in further detail when developing any proposals.
- 5.9** We have also heard concerns about the availability and consistency of 'run-off' cover for PIFs. Run-off cover is usually bought to cover liabilities where a firm has ceased to trade. It is typically sold on the basis that it is renewed annually. This runs the risk that policies fail to be renewed, for example, if the insurer decides not to offer the same terms for a subsequent year. Additionally, PII cover generally includes the firm's costs to make a legal defence against claims, which must be paid whether or not the claim succeeds. These costs can often be very high. Our current Handbook guidance says that we do not consider it reasonable for a firm's policy to treat legal defence cost cover as part of the limits of indemnity if this reduces the cover available for any individual larger claim.<sup>35</sup>
- 5.10** We would be interested in your views on whether our diagnosis of the current potential problems in PII for PIFs is correct.

<sup>33</sup> Additional requirements for limits of indemnity and for capital resources are set out at IPRU-INV 13.1.19R and IPRU-INV 13.1.23R, respectively.

<sup>34</sup> Where the policy's excess on any claim is more than £5,000, the amount of additional capital resources must be calculated in accordance with our rules in IPRU(INV) 13.1.25R and IPRU(INV) 13.1.27R.

<sup>35</sup> IPRU-INV 13.1.22(2)G.

## More comprehensive PII

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- 5.11** We consider that the relationship between the effectiveness of PII cover and claims on the FSCS raises the question of whether we should require firms to hold more comprehensive insurance policies. This could be justified if we found evidence that firms with more comprehensive PII were better protected against liabilities, more able to meet claims against them and less likely to be declared in default. This would reduce the burden on the FSCS and help to transfer costs to the firms most responsible for generating claims, through increased insurance premiums.
- 5.12** We would like to hear your views on what features a more comprehensive PII policy should include. Given the points above, we suggest that it might have the following features:
- no exclusions for the insolvency of the policyholder or of the FSCS as a claimant (meaning that the policy must provide cover for any FSCS claims) regardless of the legal status of the firm
  - restricted use of limitations (policy exclusions for particular intermediated products)
  - additional restrictions on policy excess levels (which could apply to individual or multiple claims)
  - additional requirements for legal defence costs
  - restrictions on requirements for the policyholder to notify the insurer about future possible liabilities, potentially widening the circumstances in which an insurance policy pays out, and
  - additional requirements to have in place 'run-off' cover
- 5.13** It is difficult to accurately predict which intermediated products are most likely to result in FSCS claims, although we do have some indications from existing claims data and from insurers. As we discuss in the chapter on risks and responsibilities, we believe that advice about NMPIs may pose higher risks than other areas (and in Section 3 of this paper we propose to collect additional data on these products).
- 5.14** We believe there are some further implications which we will need to consider carefully:
- More comprehensive PII would come at a commercial cost in terms of increased premiums. This may have implications for participation and competition in the advice market.
  - The 'claims made' basis of PII policies means that if a firm in financial difficulty does not pay its insurance premium, then significant numbers of claims may never be paid. This is in contrast with a 'losses occurring' policy basis where insurer of the firm at the time the relevant event occurred would be responsible for meeting any claims. This is the case for all UK PII policies, and we will need to explore the reasons for this in more detail with market participants.
- 5.15** As part of its requirements for intermediaries, the FSA initially required PII to include a number of standard policy terms. When the FSA decided to relax its standard policy conditions in 2003, it did so for two main reasons. First, that it would reduce firms' exposure to the price cycle in insurance markets which can lead to large cost increases which can be difficult for firms to

absorb. Second, that it would reduce the FSA's costs of monitoring compliance with standard policy conditions.<sup>36</sup>

- 5.16** We would need to ensure there are appropriate quality controls in place to check that firms held the mandated policies. It may not be sufficient to monitor this through the RMAR or other self-reporting mechanisms. Given the FSA's experiences, any additional checking on our part is likely to result in a high cost and may not be a proportionate use of our resources. However, the Senior Managers Regime should create the required discipline in this area. We may also want to consider involving a third party such as an industry association, or placing additional requirements on insurers or brokers in the PII market.

- Q4:** Do you have any views about the current effectiveness, or otherwise, of PII cover including in reducing the number and cost of claims on the FSCS, and about the role of PII in providing compensation to consumers who have claims against failed firms?
- Q5:** Do you have any views or suggestions about the possible features of more comprehensive, mandatory PII insurance? Do you have any suggestions about other possible tools, remedies or approaches which could be used to reduce the scale of funding currently required by the FSCS?
- Q6:** Do you have any views on the impact of a requirement on PIFs to hold more comprehensive PII? For example, what would be its impact on the PII market, the financial advice market and on consumers in general?

<sup>36</sup> FSA CP169 *Professional Indemnity Insurance for Personal Investment Firms: consultation on rule changes; and discussion of other policy options* (October 2003)

## 6. Extending consumer protection: options for change

- 6.1** In this chapter we focus on the extent of consumer protection under the FSCS and open up a range of ideas for discussion. We look at the types of activities that are and are not covered by the FSCS and the limits on compensation for consumers when they do make a claim. We discuss the potential for changes to some of the current protection limits, chiefly to reflect how the pensions landscape has changed since the current limits were put in place. We also discuss our thinking towards other issues, such as the case for and against introducing FSCS protection for loan-based crowdfunding.
- 6.2** In addition to this chapter on extending consumer protection, we are also making specific proposals for consultation in Section 3, including introducing FSCS coverage for certain consumer credit activities.

### Rethinking compensation limits

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- 6.3** The amount of compensation available to a consumer who has a claim for compensation from the FSCS varies. Different limits apply to different types of claim, as figure 6.1 shows. We committed to reviewing these compensation limits within the scope of our rulemaking responsibilities (shown in bold in the table), as part of the broader FSCS funding review. At the same time, changes to the pensions environment have prompted us to review the current limits for different products and services that can be used for saving for retirement or spending retirement funds. Flexible pension products that consumers may invest in on retirement work differently to the annuities they may have purchased previously and, importantly, may be treated differently in terms of the compensation limits that apply. In this section, we set out for discussion several options for the compensation limits in light of these factors.

**Figure 6.1 – Current FSCS compensation limits**

Type of claim	Rulemaking Responsibility	Compensation limit
Deposits	PRA	£75,000 <sup>37,38</sup>
<b>Investment provision</b> <b>Investment intermediation<sup>39</sup></b> <b>Home finance intermediation</b>	<b>FCA</b>	<b>£50,000</b>
Long-term insurance Pure protection Compulsory insurance Professional indemnity insurance Death or incapacity from injury, sickness or infirmity of the policyholder	PRA	100% of the claim
Other types of general insurance	PRA	90% of the claim
<b>Certain types of insurance intermediation claim involving:</b> <ul style="list-style-type: none"> <li>• <b>pure protection insurance;</b></li> <li>• <b>compulsory insurance;</b></li> <li>• <b>professional indemnity insurance</b></li> <li>• <b>death or incapacity from injury, sickness or infirmity of the policyholder</b></li> </ul>	<b>FCA</b>	<b>100% of the claim</b>
<b>Other types of insurance intermediation</b>	<b>FCA</b>	<b>90% of the claim</b>

### Changes in the pensions landscape

- 6.4** FCA and PRA rules do not currently provide for pensions-specific compensation limits for claims for deposits, long-term insurance contracts or investments. Therefore someone who buys a particular investment product is in the same position for FSCS limits, regardless of whether it is held in an Individual Savings Account (ISA), SIPP or a defined contribution occupational pension scheme. A consumer who invests via a life insurance contract will, under PRA rules, get 100% of their money back if the provider firm fails. However, a consumer who makes a non-insurance investment can only receive a maximum of £50,000 per failed firm.
- 6.5** There may be a potential issue with these differential limits, especially given the changes in the pensions environment. The pensions freedoms have resulted in a clear movement in the market and more consumers invest their pension funds on retirement in drawdown products instead of insurance-based annuities. The compensation limit for drawdown products is capped at £50,000 (assuming that it is not a contract for insurance), but for insurance-based annuities it is 100% of the loss with no upper limit.

<sup>37</sup> From 3 July 2015, the FSCS provides significantly higher protection for temporary high balances held with a bank, building society or credit union [www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-temporary-high-balances/](http://www.fscs.org.uk/what-we-cover/questions-and-answers/qas-about-temporary-high-balances/)

<sup>38</sup> On 21 November 2016, the PRA opened a consultation to reset the deposit protection limit at £85,000. The PRA proposes that depositors will be protected up to £85,000 as of 30 January 2017. The consultation closes on 16 December 2016. Until the proposals are finalised in a PRA policy statement, the deposit protection limit remains at £75,000 [www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4116.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp4116.aspx)

<sup>39</sup> The FSCS does not provide protection for investment losses from normal market activity.

- 6.6** Industry responses to our consultation on pension reforms in 2015<sup>40</sup> recognised that FSCS protection for pensions is complex and that there may be a case for harmonising the limits. However, the various limits serve different purposes and any proposed changes to the limits should be based primarily on cost/benefit considerations.
- 6.7** Data from a sample of firms show us that in the period July 2015 to March 2016, annuities accounted for less than 14% of the total number of pots accessed for the first time to take an income or fully withdraw money as cash (44,640 out of over 324,537).<sup>41</sup>
- 6.8** The lower limits that apply to claims for investment provision and intermediation – and including life and pensions’ intermediation – have caused concerns about the impact on consumers if invested pension funds are lost.<sup>42</sup> With only the lower compensation limit in place, pensioners could potentially be placed in financial difficulty with little or no chance to replenish their savings. At the same time, any increase in the limits implies a potential increase in levies. We must therefore find an appropriate balance between providing protection for consumers and ensuring FSCS funding is sustainable and affordable for firms. We are interested in views on where this balance should be struck.

**Other potential drivers for change**

- 6.9** The current compensation limit of £50,000 for investment business has been in place since October 2009, and may now justify a review. FSCS data also show that the proportion of investment business claims where the overall claim was greater than the £50,000 limit has increased during the period 2010 to 2014, as shown in the table below.

**Figure 6.2 – Examining the scale of investment business claims**

<b>Year</b>	<b>Total claims made</b>	<b>No. of claims over £50,000</b>	<b>% over £50,000</b>
2010	11,263	557	4.95
2011	19,075	1,072	5.62
2012	9,584	519	5.42
2013	5,543	506	9.13
2014	6,622	865	13.06

**Considering the options for coverage**

- 6.10** We have considered several options for the FSCS’s coverage of pensions-related business, and we are seeking feedback on these. The options are:
- doing nothing, leaving the limits as they are
  - increasing the limit for all investment business from £50,000 to £75,000
  - increasing the limit for all investment business from £50,000 to £100,000

40 CP 15/30, Pension reforms – proposed changes to our rules and guidance (October 2015) [www.fca.org.uk/publication/consultation/cp15-30.pdf](http://www.fca.org.uk/publication/consultation/cp15-30.pdf)

41 FCA Data Bulletin Supplement, Retirement income market data (April 2016), [www.fca.org.uk/publication/data/data%20bulletin%20suppl%20apr%2016.pdf](http://www.fca.org.uk/publication/data/data%20bulletin%20suppl%20apr%2016.pdf)

42 The FSCS does not provide coverage for investment losses which are purely due to movements in the value of assets, and we do not propose any change to this.

- increasing the limit for all investment business from £50,000 to £150,000 (which is the same as the award limit at the FOS)
- increasing the limit for all investment business from £50,000 to £1 million (which is the same as the pensions lifetime allowance)
- differentiating between investment provision and investment and life and pensions intermediation, and increasing the limit for investment provision claims only, and
- seeking to identify pensions-related claims as distinct from those made for 'traditional' investments, and introducing higher limits for claims for investment arrangements or services used purely for retirement planning.

### Understanding the impact of any changes to limits

#### Pre-pensions freedoms

**6.11** We provide a summary of our analysis of historical claims data supplied by the FSCS for the period 2010 to 2014 below.

**6.12** The table shows the impact on those historical claims if the compensation limits for investment business had been £75,000, £100,000, £150,000 or £1 million, instead of £50,000.

**Figure 6.3 – Examining the impact of different limits using historical claims data**

COMPENSATION LIMIT	Number of less than fully compensated claimants (% of claims in that class)		
	Investment Provision (total claims – 36)	Investment Intermediation (total claims 52,051)	Life & Pensions Intermediation (total claims 12,880)
£50,000	3 (8.3%)	3,517 (6.7%)	966 (7.5%)
£75,000	0 (n/a)	1,708 (3.3%)	595 (4.6%)
£100,000	0 (n/a)	950 (1.8%)	404 (3.1%)
£150,000	0 (n/a)	408 (0.8%)	184 (1.4%)
£1,000,000	0 (n/a)	6 (0.01%)	2 (0.02%)

**6.13** The above data reflect that, had the limits been £75,000/£100,000/£150,000/£1 million:

- all claims in the Investment Provision class would have been fully met, up from 91.7%
- 96.7%/98.2%/99.2%/virtually 100% of all claims in the Investment Intermediation class would have been fully met, up from 93.3%, and
- 95.4%/96.9%/98.6%/virtually 100% of all claims in the Life & Pensions Intermediation class would have been fully met, up from 92.5%

**6.14** Our analysis also indicates that, had the limit been £75,000, total compensation costs in the period would have been almost £79m (6.3%) higher. For a limit of £100,000, compensation costs would have been £123.2m (9.8%) higher. With a compensation limit of £150,000, compensation costs would have been £167.7m (13.3%) higher (and for a limit of £1 million (in line with the option to increase the limit to £1 million for investment provision and investment intermediation only), it is likely that total compensation paid would have increased only slightly further than this).

**Post-pensions freedoms**

**6.15** Since the introduction of the pensions freedoms, we have been collecting data from firms on the:

- numbers of plan holders in the accumulation (saving for a pension) stage
- numbers of plan holders in decumulation (using pension savings in retirement)
- value of assets under administration (accumulation and decumulation), and
- proportion of ‘pot sizes’ for those plans in partial drawdown

**6.16** From the data we can calculate the impact on the proportion of plans that would be fully covered if the compensation limits were increased. The table below summarises our analysis.

**Figure 6.4 – Examining the potential extent of coverage for currently held plans**

COMPENSATION LIMIT	% of plans fully covered	Average pot size fully covered <sup>43</sup>
£50,000	67%	£19,162
£75,000	76%	£24,794
£100,000	85%	£29,260
£150,000	91%	£35,252

**6.17** According to the FSCS data, in the period 2010 to 2014, there were only 6 claims out of a total of 52,087 that exceeded £1 million. Therefore, a £1 million limit would have provided virtually 100% protection in that period.

**6.18** While only 9% of the pension pots in the table currently exceed £150,000, this is likely to change. The Government has estimated that 9 million people will be automatically enrolled by 2018, or will contribute more, and increase the amount that is being saved by around £15bn a year by 2019/20.<sup>44</sup>

**6.19** We also recognise that to introduce a higher limit of protection, particularly one that applied to all investors, could increase the risk to the FSCS’s costs becoming unsustainable due to potentially high-value future claims. It could also encourage greater risk-taking by firms or consumers on the assumption that the investment may be underwritten by the FSCS. As stated earlier, the FSCS does not cover investment losses which are purely due to movements in the value of assets, but it is possible that consumers could misunderstand and believe otherwise.

**Differentiating between different products and services**

**6.20** We have considered the issues resulting from differentiating between investment provision and investment and life and pensions intermediation, and possibly increasing the limit for investment provision claims only. This is because there is currently a disparity in protection between life and pensions and investment provision claims, but no disparity between the two different kinds of intermediation claim. FSCS claims data show that, in the period 2010 to 2014, they received only 36 claims in the investment provision class, out of a total of approximately 125,000 FSCS claims. Of those, only 3 exceeded the £50,000 limit and none exceeded the

<sup>43</sup> The average pot size gives an indication of the increase in costs should a failure occur, assuming the failed firm’s profile of pension pots is similar to the data we have.

<sup>44</sup> Department for Work & Pensions, *Automatic Enrolment evaluation report 2015* (November 2015) [www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/477176/rr909-automatic-enrolment-evaluation-2015.pdf](http://www.gov.uk/government/uploads/system/uploads/attachment_data/file/477176/rr909-automatic-enrolment-evaluation-2015.pdf)

limit by more than £25,000. By comparison, over 52,000 claims were made for investment intermediation; evidence that this is where future claims are more likely to arise. Therefore, to increase the limit only for investment provision claims might actually do little to improve FSCS protection for pension-focused investors, as they are much more likely to need to claim for the failure of an intermediary firm which has given them negligent advice.

- 6.21** We also considered whether we might be able to differentiate between investments used for retirement savings from non-pension investments, and how we might apply higher levels of protection to the pensions business. We think this would be challenging. The FSCS would need to be able to identify the investments a consumer might use to manage their pension pot on retirement and require firms to establish a clearly identifiable relationship between the pension pot and whatever investment is made. This could become particularly complicated when a pension-focused investment is subsequently added to, moved, split or otherwise changed at some point in the future. We would also need to consider whether or not consumers would understand such distinctions.
- 6.22** We are not consulting on any one particular option at this point, but would welcome your feedback on the options set out above, or alternative proposals.

**Q7: Would you support an increase to the FSCS compensation limit in relation to any or each of the investment provision, investment intermediation and life & pensions intermediation classes? If so, do you have any views on what those limits should be?**

**Q8: Would you support a proposal to differentiate between investment provision and investment intermediation, and to introduce higher limits for either? If so, do you have any views on what those limits should be?**

**Q9: Would you support a proposal to seek to make a distinction between pensions-related investment business and non-pensions investment business, and apply higher limits for pensions-related investments? If so, do you have any views on how the distinction might be made and what those limits should be?**

### Loan-based crowdfunding

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- 6.23** When we took on the regulation of consumer credit in 2014, this also included firms involved in loan-based crowdfunding. Our regulation covers both firms lending through loan-based crowdfunding (peer-to-peer) platforms and investment-based crowdfunding platforms, which offer investors the chance to invest in unlisted shares, or debt securities issued by businesses. Loan-based crowdfunding is not currently included within the scope of FSCS cover, which means that investors could not seek compensation from the FSCS if a firm operating a loan-based crowdfunding platform failed. We do not discuss the arrangements for investment-based crowdfunding in this section, as this is already covered.
- 6.24** Our current regulatory arrangements help to protect investors by ensuring that firms give them information which is fair, clear and not misleading. However, we are also currently undertaking a post-implementation review of our crowdfunding rules. As part of this we published a Call

for Input in July 2016, which describes our approach in further detail.<sup>45</sup> In our response to the Call for Input, published on 9 December,<sup>46</sup> we said that we remain concerned that standards of disclosure in loan-based crowdfunding do not meet our expectations. To help firms and raise standards, we plan to consult on additional provisions to provide a consistent minimum basis for investor disclosures. Additionally, firms must ensure that client money is adequately protected and they must meet minimum capital requirements.

- 6.25** Although this is a small market in terms of the number of firms involved, it is developing rapidly and we are keen to ensure that we are aware of any emerging risks to ensure our regulation provides appropriate levels of consumer protection. Developments in the market, such as the greater pooling of credit risk, and changes to the investor base could create new risks for investors. Additionally, we know that if market conditions change, such as a rise in interest rates, crowdfunding firms could be more likely to fail. However, it is also hard to predict the possible wider impact on the market of an individual crowdfunding firm failing and whether this might damage investor confidence and lead to more firms failing as a result.
- 6.26** Even if firms fail, we believe the resulting risk of an investor losing money is small. This is because, in practice, client money which has been received by the crowdfunding firm but has yet to be invested must be held by a third party, such as a bank, rather than by the firm. As well as benefiting from the protection provided by client asset and client money rules, investors may be able to recover money from the third party should the firm become insolvent, and loans can be administered by another platform. Overall, given the small scale of the market (including issues around the sustainability of an FSCS crowdfunding class), and what we believe to be a low risk to client funds on the default of a firm, we are not convinced that FSCS protection should be introduced.
- 6.27** However, we welcome views about the extent to which a failing crowdfunding firm may pose a risk to investors. We are conscious that it may not be sufficient to rely on client asset or client money rules, particularly when there are a variety of business models with different approaches to client money, such as using payment service providers (PSPs) to receive and hold client money or bank accounts which fall under the Solicitors Regulation Authority (SRA) rules. Our prudential rules, client money protection rules and compensation rules can be used together to provide different, but complementary, forms of protection. But, at the moment, FSCS protection is only available in this area in relation to client money or assets when in a third-party account. Consumers would not be able to claim from the FSCS in relation to activities by the firm running the platform, such as in relation to misleading disclosures. If we extended FSCS coverage to loan-based crowdfunding, investors might also be able to make a claim where a firm had misrepresented the risk of a loan, causing the investor to make an investment they would not have made without that misrepresentation.
- 6.28** In summary, despite a number of concerns we have with this market, we do not currently believe that there is a need to introduce FSCS coverage for loan-based crowdfunding, but we are seeking views on this. If we were to bring crowdfunding within the scope of FSCS protection we would need to consider carefully how this would be funded and which firms would contribute, given that crowdfunding firms alone would be unlikely to form a sustainable funding class.

**Q10: Do you have any comments about the possible risks to investors posed by crowdfunding and whether these might justify introducing FSCS protection?**

<sup>45</sup> Call for input to the post-implementation review of the FCA's crowdfunding rules (July 2016).

<sup>46</sup> FS16/13 Interim feedback to the call for input to the post-implementation review of the FCA's crowdfunding rules (December 2016).

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### Including other activities within scope

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- 6.29** We have also considered whether there may be other activities which we should bring within the scope of FSCS protection and we welcome comments or views on this. In particular, we have considered whether FSCS protection should be extended to financial promotions. A financial promotion is a communication of an invitation or inducement to engage in investment activity.<sup>47</sup>
- 6.30** Issuing and approving financial promotions are not regulated activities under FSMA, although there are a number of regulated activities which individuals or firms may undertake in the course of promoting products.<sup>48</sup> FSMA also states that an unauthorised person must not communicate a financial promotion, unless the content of the promotion is approved by an authorised person.<sup>49</sup>
- 6.31** This means that a firm which communicates a financial promotion does not contribute to the FSCS compensation costs, even though its actions could be regarded as causing loss to consumers. However, in cases we have considered, the FSCS has been able to establish that an authorised firm communicating financial promotions has also been carrying on other regulated activities which have caused investors' losses and has been able to provide compensation as a result. Therefore, we do not believe that there is sufficient evidence to justify extending FSCS protection to the activity of promoting alone. However, we would welcome further evidence on this.

**Q11: Do you have any comments about the scope of the FSCS and whether promoting financial products, or any other activities, should be included within its coverage?**

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<sup>47</sup> For more detail, see section 21 of FSMA and the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, SI 2005/1529.

<sup>48</sup> As set out in our Perimeter Guidance Manual, Chapter 8: Financial promotion and related activitiesdebt management.

<sup>49</sup> Section 21 FSMA.

## 7. Reviewing the funding classes and smoothing costs

- 7.1** In this chapter we outline for discussion ways of tackling volatility in FSCS levies through a revised class structure. We look at ideas in the FAMR report for merging funding classes, making greater use of credit to smooth the FSCS levies and make proposals for revised FSCS funding classes. Our proposals include changes to increase the role of product providers.

### Tackling volatility and spreading costs

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- 7.2** In Chapter 2, we highlighted the volatility some firms have faced in recent years in the scale of their FSCS levies. We explored a range of options for tackling this problem and describe our thinking and outline our various proposals for revised funding classes below.

### Using credit to smooth levies

- 7.3** Following on from FAMR's recommendations, we explored the idea of using the FSCS's credit facility to smooth levy payments for firms. Using either the FSCS's current credit facility or a similar fund to spread payment of significant compensation costs, and resulting fluctuations in running costs, could make the FSCS levies more predictable and allow firms to budget on a longer-term basis. However, this approach would increase the overall cost to firms because of the costs of borrowing.
- 7.4** We asked the FSCS to explore the options available to them in securing additional credit facilities. They considered various forms of funding, including bank loans, issuing bonds and using insurance-based solutions. While they concluded that bank loans were feasible, the costs are potentially very high, particularly if they need access to the credit within a short timescale to pay out compensation.
- 7.5** The FSCS believes that the cost of an undrawn revolving credit facility would be between £3m and £9m each year, depending on factors including the scale of credit available. In real terms, we believe this would be likely to translate into an increase of between 12% (£3m) and 38% (£9m) on all firms' portion of the 2015/16 base costs levy, as explained in Chapter 2.
- 7.6** We do not believe the benefits of smoothing volatility in FSCS levies are balanced by the costs of accessing credit, given that firms are concerned not just about volatility in the levies but also their overall scale. It is also worth noting that individual firms themselves can already gain access to credit to spread the costs of FSCS levies and other regulatory fees (which we discuss further in the next section). Accessing credit through FSCS would mean putting a credit facility in place which would be capable of covering the total amount of levy required. This larger amount of borrowing would mean an increase in costs spread across all firms, as opposed to the current arrangement where firms are able to access credit commercially if they require it and are only charged on the amount they individually need to borrow. For the FSCS, there could also be significant operational complexities in managing a borrowing facility. As discussed in Chapter

2, any system of pre-funding where contributions and compensation are collected and paid out over different time periods will prompt practical challenges and questions, such as whether firms leaving the market should have to pay exit levies.

**Q12: Do you agree that it would not be justified for the FSCS to utilise a credit facility to further smooth levies, given the costs involved?**

**Diversifying classes and reducing exposure to shocks**

- 7.7** In recent years the industry has been vocal about the scale and volatility of FSCS levies (as illustrated in the diagram ‘Recent trends in the FSCS levies’ in figure 2.5). FAMR focused on the variability of levies and suggested that we consider reforming the FSCS funding classes to better distribute the burden of FSCS funding among intermediaries. We want to open up discussion about possible changes to the class structure. In the next section we set out various possible models for the future, including one that merges the current intermediation classes together to reduce the volatility of FSCS levies faced by firms.
- 7.8** As discussed in Chapter 2, we are aware that some stakeholders are keen for us to further sub-divide the current funding classes to try to increase the similarities between firms that are grouped together and they are likely to have concerns about the various class structures we are considering. However, it is likely there would be more volatility and potential shocks if we were to do this. Therefore, we believe that tackling levy volatility, combined with the importance of sustainable funding classes, is likely to outweigh some concerns about the current or possible future grouping of firms (as illustrated in the next section).
- 7.9** While the previous funding review tried to minimise the number of firms that felt they had ‘no connection with the firm giving rise to the claims’,<sup>50</sup> we acknowledge it is not possible to avoid grouping firms with others that sell quite different products or have quite different business models. We believe that by putting forward proposals to increase provider contributions and review the make-up of the classes it should be possible, to varying degrees in different parts of the market, to change the funding arrangements to help make levies more predictable.

**Q13: Do you believe that we should seek to reduce the number of funding classes, in order to reduce volatility of FSCS levies?**

**Changing the funding classes**

- 7.10** We want to set out and illustrate different options for changing the FSCS funding classes. At one end of the spectrum, we consider merging the four current intermediation classes and introducing product provider contributions to a single, new intermediation class. At the other extreme, we consider the implications of introducing contributions from the relevant product providers to each separate intermediary claims class.
- 7.11** Once we construct different options, we can look at previous years to see how the various class structures would have affected firms’ levies (see Annex 4 for our analysis in full). The three class structure options we are considering are:

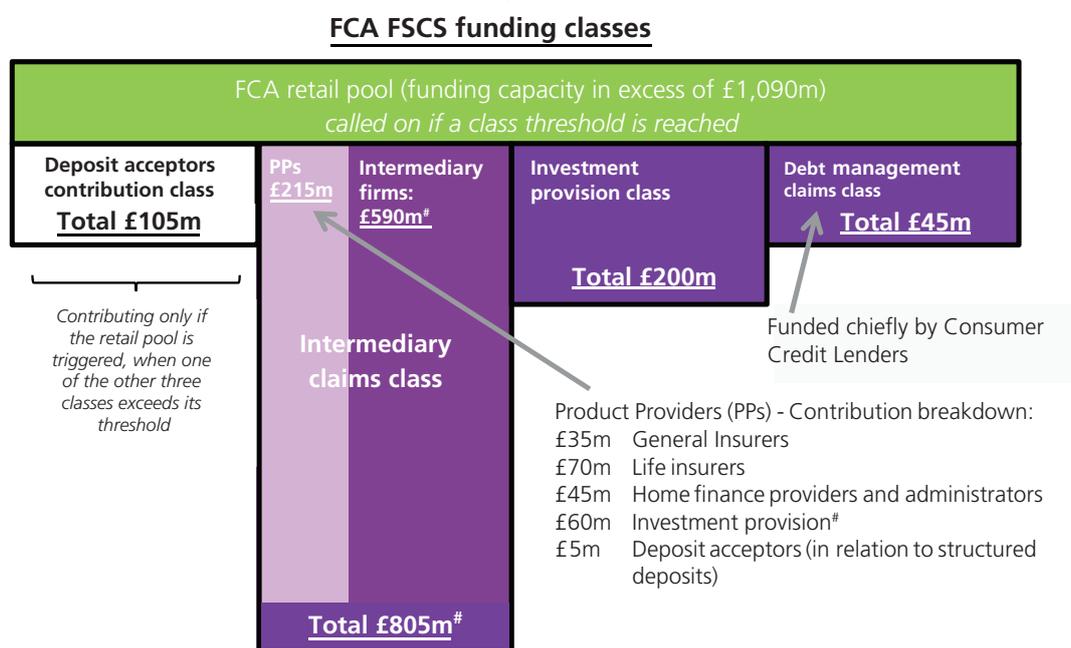
<sup>50</sup> PS 13/4, *FSCS funding model review – feedback on CP13/1* (March 2013).

- merging the four current intermediation classes with product provider contributions from all providers from the first pound of any claim (Option 1)
- merging Investment intermediation and Life and Pensions intermediation with product provider contributions from the relevant provider classes from the first pound of any claim (Option 2), and
- keeping the current intermediary class structure with increased product provider contributions from the relevant provider classes from the first pound of any claim (Option 3)

**7.12** We provide diagrams of all three class structures in this chapter. For all options, we propose to maintain the Investment Provider class and the new Debt Management Claims class as separate from the other classes.

**7.13** We took each of these possible class structures, and applied them retrospectively to claims data from 2011-2016 to demonstrate the impact each option would have on firms' costs<sup>51</sup> compared to the current structure. The projections are based on data from the current structure and therefore do not incorporate changes in scope that we propose in Section 3 of this paper (ie debt management, structured deposits intermediation and CISs).

**Figure 7.1 – Option 1:** single merged intermediation class – Life and Pensions, investments, General Insurance and Home Finance (with provider contributions)



<sup>#</sup> The diagram includes the maximum possible contribution of investment provision firms to the intermediary claims class: the class threshold would be reduced by £60m if the investment provision class had already reached its threshold.

51 Note that in these tables the provider contributions include any amounts paid in this period for claims as a result of provider failures. Figures may not sum exactly due to rounding.

**Figure 7.2 – Retrospective claims data for Option 1**

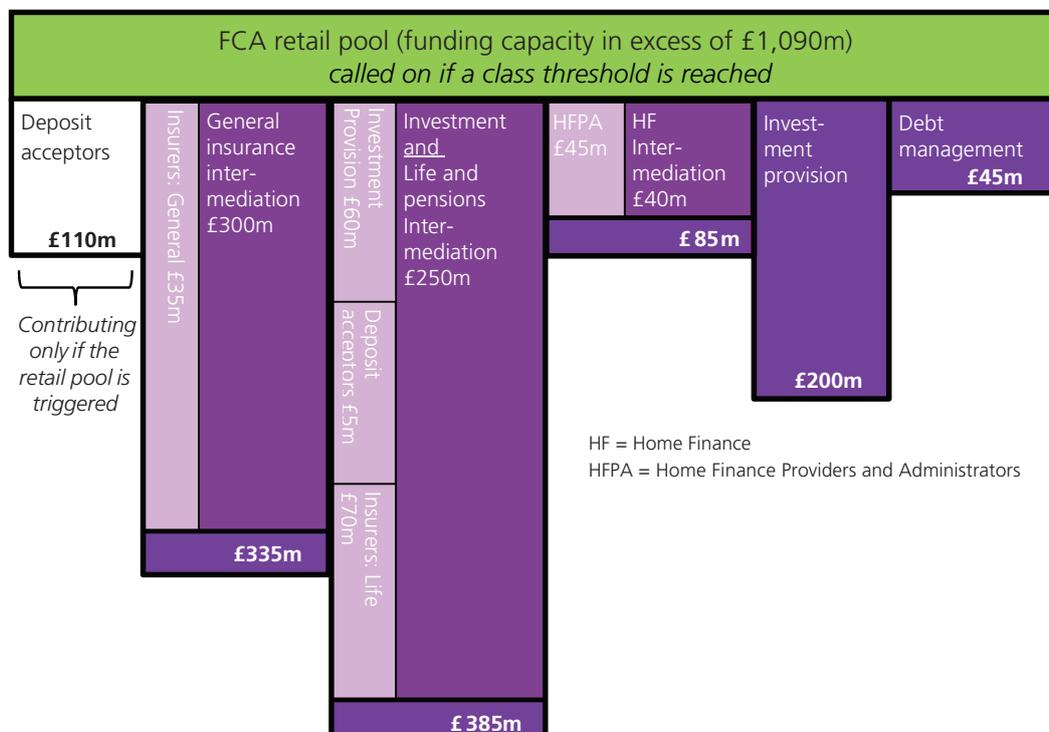
	Actual Contributions Paid		Contributions Under Option 1 <sup>52</sup>	
	Average 2011-16	Levy as % of AEI or equivalent <sup>53</sup>	Average 2011-16	Levy as % of AEI or equivalent
<b>Intermediation</b>				
General Insurance	£40m	0.44%	£65m	0.73%
Life & Pensions	£44m	1.36%	£23m	0.73%
Investments	£81m	2.26%	£27m	0.73%
Home Finance	£3m	0.24%	£8m	0.73%
<b>Provision</b>				
General Insurance	£72m		£79m	
Life & Pensions	£8m		£22m	
Investments	£0m		£12m	
Home Finance	£0m		£9m	
<b>Deposits</b>	£12m		£13m	

- 7.14** This option would result in a smaller number of classes, which would spread risk more evenly across firms. It should reduce the volatility of levy payments and better reflect the responsibilities of firms in the industry. However, when analysing this option using the data from 2011-16 (above), we see that it significantly increases the relative contributions of general insurance intermediaries and, to a lesser extent, home finance intermediaries, compared with other intermediaries. It also significantly reduces the contributions paid by life and pensions and investment intermediaries. Under this model, intermediary firms would all pay the same percentage of their annual eligible income (AEI) in future. Provider contributions have increased, reflecting the contribution to the respective Intermediary classes.

<sup>52</sup> These projections are based on data from the *current* structure and therefore do not incorporate the changes in scope that we propose in Section 3 of this paper (relating to debt management, structured deposits intermediation and CISs) – despite these scope changes being included in the illustration above.

<sup>53</sup> While intermediaries' and investment providers' contributions are calculated based on their Annual Eligible Income (AEI), providers' contributions are calculated on a different basis.

**Figure 7.3 – Option 2:** Life and Pensions and Investment Intermediation merged, Home Finance and General Insurance remain separate (with provider contributions)



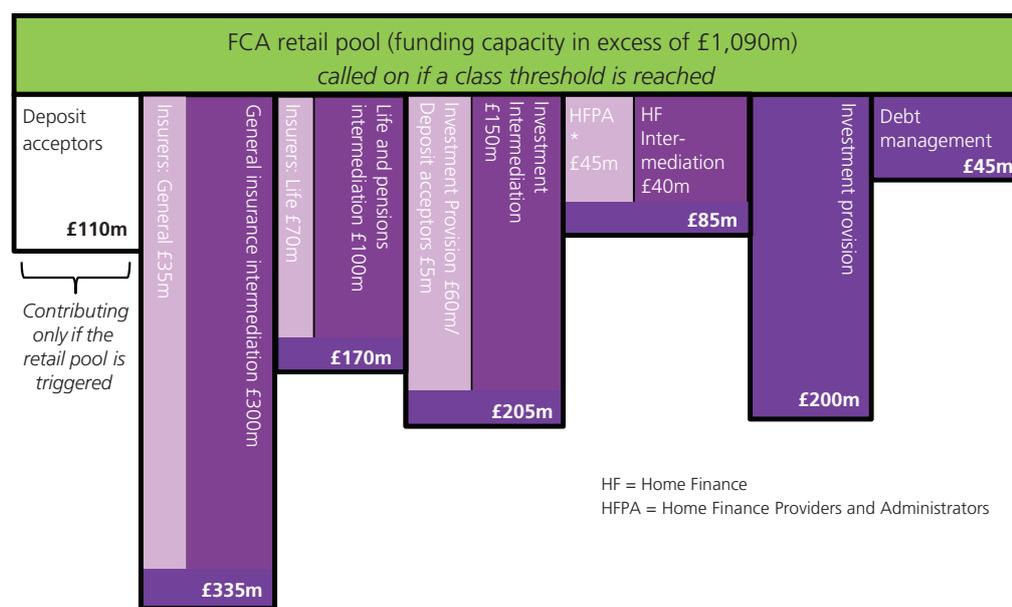
**Figure 7.4 – Retrospective claims data for Option 2**

	Actual Contributions Paid		Contributions Under Option 2 <sup>54</sup>	
	Average 2011-16	Levy as % of AEI or equivalent	Average 2011-16	Levy as % of AEI or equivalent
<b>Intermediation</b>				
General Insurance	£40m	0.44%	£35m	0.40%
Life & Pensions	£44m	1.36%	£37m	1.16%
Investments	£81m	2.26%	£44m	1.22%
Home Finance	£3m	0.24%	£1m	0.11%
<b>Provision</b>				
General Insurance	£72m		£76m	
Life & Pensions	£8m		£30m	
Investments	£0m		£20m	
Home Finance	£0m		£1m	
<b>Deposits</b>	£12m		£13m	

54 These projections are based on data from the *current* structure and therefore do not incorporate changes in scope that we propose in Section 3 of this paper (relating to debt management, structured deposits intermediation and CISs) – despite these scope changes being included in the illustration above.

- 7.15** This option reduces the relative contributions of all intermediary classes, particularly for the Investment Intermediation class and, to a lesser extent, Life and Pensions intermediaries. It roughly halves the contributions paid by Home Finance intermediaries. Under this model, intermediary firms are still paying a different percentage of their AEI, but there is less disparity between them. Provider contributions have increased, reflecting the contribution to the respective Intermediary classes.

**Figure 7.5 – Option 3:** the current intermediary class structure (with provider contributions)



**Figure 7.6 – Retrospective claims data for Option 3**

	Actual Contributions Paid		Contributions Under Option 3 <sup>55</sup>	
	Average 2011-16	Levy as % of AEI or equivalent	Average 2011-16	Levy as % of AEI or equivalent
<b>Intermediation</b>				
General Insurance	£40m	0.44%	£35m	0.40%
Life & Pensions	£44m	1.36%	£26m	0.80%
Investments	£81m	2.26%	£57m	1.57%
Home Finance	£3m	0.24%	£1m	0.11%
<b>Provision</b>				
General Insurance	£72m		£76m	
Life & Pensions	£8m		£26m	
Investments	£0m		£23m	
Home Finance	£0m		£1m	
<b>Deposits</b>	£12m		£13m	

<sup>55</sup> These projections are based on data from the *current* structure and therefore do not incorporate changes in scope that we propose in Section 3 of this paper (relating to debt management, structured deposits intermediation and CISs) – despite these scope changes being included in the illustration above.

- 7.16** This option also reduces the relative contributions of all intermediary classes. The difference between AEI contributions for the intermediary classes is wider than under the other options, as the model provides only a limited smoothing effect. Provider contributions have increased in this example, reflecting the contribution to the respective intermediary classes.

**Q14: What are your views on the different funding classes we have set out here? Do you have any alternative proposals?**

### Assessing the affordability of the class thresholds

- 7.17** In line with the affordability analysis (Annex 4), we do not see a case for changing the current class thresholds. Instead, we would expect to keep the current class thresholds but combine them as appropriate to form the new thresholds, depending on the class structure adopted.
- 7.18** As previously discussed, we propose to introduce product provider contributions towards intermediary firm failures. Under the three options in this chapter, the percentage contribution of each provider for intermediary claims varies. Additionally, while providers would be charged from the first pound of any claim, the total maximum amount providers could be called on to contribute remains the same as the amount determined as affordable under the previous review.

**Q15: Do you agree with our intention to keep the current class thresholds for intermediary classes, merging the thresholds if appropriate to adopt a revised class structure?**

**Q16: Do you agree with our intention to keep our current class threshold of £200m for the investment provision class?**

### Understanding how the new classes and the retail pool would work

- 7.19** We foresee that there would be a retail pool with all of the class options, in order to provide extra funding support. The retail pool is called upon if costs in a particular funding class are so high that firms in other classes need to be called upon to contribute. However, the way the retail pool would operate under each option would be slightly different. Because of this, we will consult further on the retail pool at a later date together with the funding class option.

### Exploring fixed levy payments for smaller firms

- 7.20** Another idea put forward to reduce volatility – at least for a portion of the market – is to introduce a fixed levy for smaller firms.<sup>56</sup> This is an idea that we have considered, having introduced fixed FCA fees for small firms.<sup>57</sup> However, we are not convinced that this approach is worth pursuing.
- 7.21** If a fixed levy for small firms had been in place in 2015/16, using the same criteria as for FCA fees, just over 3,500 firms would have paid it (down from nearly 6,000 in 2010/11 due to firms’

<sup>56</sup> Defined as firms with an income from regulated activities below £100,000.

<sup>57</sup> Minimum fees were consulted on in 2009 under the FSA in CP09/26, *Regulatory fees and levies: policy proposals for 2010/11 (November 2009)*, [www.fsa.gov.uk/pubs/cp/cp09\\_26.pdf](http://www.fsa.gov.uk/pubs/cp/cp09_26.pdf)

increasing total incomes). This is based on a small firm being defined as one with an income of less than £100,000 from their regulated activities. For this group of firms to have contributed the same amount as they actually paid, over the past six years, each would have needed to pay around £400 per year in FSCS levies, as shown in the graph below. However, this does not include the effect of the class structure. To ensure the right amount was collected for each class historically, the minimum contribution would have been £750.

- 7.22** If firms were in favour of a minimum levy, it is likely that the amount set would be slightly more than has been required historically. This would allow us to provide reasonable certainty about not needing to make future changes, so a fixed levy for FSCS for small firms would be likely to be set around £850. Were we to set the levy at a lower amount, this would be likely to require ongoing cross-subsidisation from others, which may not be desirable or sustainable.

**Figure 7.7 – Minimum contribution needed per firm to cover historical levies for smaller firms\***



\*Firms with an income below £100,000

- 7.23** Overall, it is not clear to us that there is a compelling case for introducing a fixed levy for smaller firms, as it would probably mean all these firms paying a minimum of £850. While this approach would reduce volatility for smaller firms and increase certainty about their FSCS bills, it would also increase the levies paid by those firms that currently pay the smallest bills. Over the last six years, 82% of smaller firms have paid FSCS levies of less than £850.
- 7.24** We are also aware that introducing a fixed levy for smaller firms would have to be balanced by slightly greater fluctuations in levies paid by other firms. While in the longer term there is no reason to think that smaller firms would pay more or less than their fair share under a fixed levy, it is still not clear that they would welcome such an approach.

**Q17: Do you have any views on the idea of a fixed levy for smaller firms?**

## 8.

# Reviewing the funding classes: potential product provider contributions

- 8.1** In this chapter we propose thresholds for the money that could be raised from the various proposed funding models, which we described in the previous chapter. In our analysis in this chapter, we refer to historic data to illustrate the potential impact of different models. As a result we assume that there is no change to the level of FSCS claims (for example, driven by any improvement in the comprehensiveness of firms' PII cover) in our analysis.

### Affordability modelling

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- 8.2** We have analysed the affordability of the FSCS funding model in order to support the development of the FSCS class structure proposals. This analysis is set out in Annex 4.

### Affordability of product provider contributions

- 8.3** In Chapter 7 we explained different options for introducing product provider contributions to intermediary claims classes, depending on the relevant class structure option. In all the class structures we are considering, we have suggested that product provider contributions start from the first pound of relevant claims. This change means product providers would always contribute a portion of costs for intermediary claims. This is in contrast to the current structure, where product providers only contribute when an intermediary's class threshold is breached. We suggest that these contributions should be distributed across product providers in proportion to the existing threshold limits.<sup>58</sup>

### Product provider contributions under the different options

- 8.4** For option 1, we propose that product providers contribute to the new intermediary claims class up to a maximum threshold of £215m. This would mean they contribute approximately 27% of the bill for intermediary claims. The following providers would contribute up to the stated set maximum threshold amounts:
- general insurance providers – £35m
  - life insurance providers – £70m
  - home finance providers and administrators – £45m
  - investment providers – £60m, and
  - deposit acceptors (reflecting the introduction of structured deposits into the class) – £5m

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<sup>58</sup> The PRA is responsible for the thresholds set for deposit acceptors and insurers, which are unchanged by our review.

- 8.5** In both options 2 and 3 the percentages that product providers would contribute to intermediary claims would differ, as providers would only contribute to the class (or classes) of claims with which their products are associated. The monetary amounts that providers would contribute would remain the same as for option 1, but their contribution in percentage terms changes to:
- general insurance providers – £35m, 10% of costs for General Insurance Intermediation
  - home finance providers and administrators – £45m, 53% of costs for Home Finance Intermediation class
  - life insurance providers – £70m, 18% of costs for the merged Investment and Life & Pensions Intermediation class
  - investment providers – £60m, 16% of costs for the merged Investment and Life & Pensions Intermediation class, and
  - deposit acceptors – £5m, 1% of costs for the merged Investment and Life & Pensions Intermediation class
- 8.6** Under option 3 the percentages which product providers would contribute to intermediary claims would represent the following percentages:
- general insurance providers – £35m, 10% of costs for General Insurance Intermediation
  - home finance providers and administrators – £45m, 53% of costs for Home Finance Intermediation class
  - life insurance providers – £70m, 41% of costs for Life & Pensions Intermediation
  - investment providers – £60m, 28% of costs for Investment Intermediation, and
  - deposit acceptors – £5m, 2% of costs for Investment Intermediation
- 8.7** These provider limits mirror the current thresholds of the respective classes in the general retail pool, apart from investment provision whose overall contribution is to be capped by that funding class's current threshold.
- 8.8** Under our proposals, Investment Providers would contribute up to £60m towards the relevant intermediary claims class. Investment provider overall contributions would be capped at £200m (across both their contribution to the intermediary claims class and claims in the investment provision class).<sup>59</sup>

**Q18: Do you have any comments on the mechanism by which we would propose to incorporate product provider contributions into the intermediary claims classes, for the various different class structure options described?**

<sup>59</sup> If the investment provision class required the full £200m to cover claims, any amounts that had been previously contributed to the intermediary claims class would need to be returned. This mirrors the current arrangements for the FCA provider contribution classes that are included in the retail pool and is outlined in FEES 6.5A.2R.

## Section 3

# Specific proposals for consultation

## 9. Extending consumer protection: specific proposals

- 9.1** In this section, we set out our proposals for specific changes to our rules and guidance, starting with proposals to extend the consumer protection provided by the FSCS. This includes specific proposals to introduce FSCS protection for some consumer credit activities and for structured deposit activities. We also propose to amend the scope of the FSCS in other areas, including collective investment schemes (CISs) and for Lloyd's of London.

### Protection in the consumer credit market

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- 9.2** Consumer credit activities were brought within FCA regulation in April 2014. We did not extend FSCS cover to any of the new activities at that time, but said we would look at this issue when firms were fully authorised.<sup>60</sup> Having now considered the issue in more detail, we still believe that most consumer credit activities should remain outside FSCS protection because our other regulatory requirements are sufficient. However, we also believe extending protection to certain debt management activity may be justified for the reasons set out below.

### Should debt management activities be covered by the FSCS?

- 9.3** Our consumer credit rules introduced a number of new requirements for debt management firms. Key among them were the requirements for firms to pass on more money to creditors from the start of a debt management plan and to protect client money. We believe this delivered important protection for consumers. However, in 2015 we undertook a thematic review of the quality of debt management advice<sup>61</sup> and our feedback to that review<sup>62</sup> highlighted a number of concerns. These included:

- some firms provide debt advice that may not be in the customer's best interests and recommend debt solutions that are not always suitable, affordable and sustainable, and
- client money is not always adequately protected, accounted for or passed to creditors in a timely manner

- 9.4** Our authorisations and supervisory processes should help address these concerns, but, in certain circumstances, activities could mean a debt management firm will owe liabilities to its clients. Where a debt management firm fails, the impact on individual consumers could be substantial. The monthly payment cycle of debt management plans and other 'debt solutions' means that, while the overall amount of client money a firm might lose is relatively low, the

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60 For further details see FCA CP13/10 Detailed proposals for the FCA regime for consumer credit – including feedback to FSA CP13/7 and the policy statement on high-level rules that we consulted on in FSA CP13/7 (October 2013).

61 FCA TR15/8 *Quality of Debt Management Advice (June 2015)*, [www.fca.org.uk/publications/thematic-reviews/tr15-8-quality-debt-management-advice](http://www.fca.org.uk/publications/thematic-reviews/tr15-8-quality-debt-management-advice)

62 [www.fca.org.uk/publications/thematic-reviews/tr15-8-quality-debt-management-advice](http://www.fca.org.uk/publications/thematic-reviews/tr15-8-quality-debt-management-advice)

individual clients may feel these losses acutely, given they are already in debt and may be vulnerable in other ways.

- 9.5** A typical debt management plan is a voluntary arrangement where a client enters into an agreement with a debt management firm who will administer the client's debts on their behalf. The firm normally collects monthly payments from the client and passes these to the client's creditors in prearranged amounts. Other types of debt solutions such as statutory 'debt arrangement schemes' exist in Scotland. We propose to provide FSCS protection to some of these different arrangements.

### **Introducing FSCS protection for debt management**

- 9.6** We propose to introduce FSCS protection for certain claims made for the debt management activities of debt counselling or debt adjusting, when they are undertaken as part of an individual entering into a 'debt solution' to discharge their debts.<sup>63</sup>
- 9.7** We will do this by adding a new category of 'protected claim' into our Compensation Sourcebook (COMP), namely a claim for client money lost by a protected debt management business. By protected debt management business, we mean debt management activity<sup>64</sup> carried out by a CASS debt management firm<sup>65</sup> that holds client money and meets certain conditions around where the firm does business.<sup>66</sup> There may be other forms of debt solutions, such as individual voluntary arrangements (IVAs) which are arranged by insolvency practitioners, which would not come within the scope of FSCS protection.
- 9.8** We do not propose to extend protection to advice given by these firms or to firms which do not hold client money, as they potentially pose only a limited risk to their clients. However, we would welcome views on whether we should provide coverage for negligent advice in this sector, bearing in mind that the FSCS does cover negligent advice in other contexts, such as negligent investment advice.
- 9.9** We only propose to provide protection for UK-based debt management firms. These are firms who have a UK establishment and where the eligible claimant usually lives in the UK or any other EEA State. We recognise that in some cases, clients of UK debt management firms may no longer normally live in the UK but still owe debts to UK lenders.
- 9.10** In our draft rules in Appendix 1, we have set the compensation limits for protected debt management business at 100% of any claim, with a maximum payment of £50,000. We believe this is likely to provide full protection for clients of debt management firms. It will also bring the limits on protection in this new area in line with the FSCS limits for some other activities. The new debt management claims class will also form part of the retail pool. It will contribute to other classes if their limits are breached and will benefit from the retail pool if it exceeds its levy threshold of £45m.
- 9.11** Given our proposed introduction of FSCS cover for debt management activities, we also consider it necessary to ensure debt management firms disclose the right information to their customers. As set out above, we propose that our rules only provide cover for the loss of client money, and we want to ensure consumers are aware of the limitations of cover. Therefore we propose to introduce new rules in the Consumer Credit sourcebook (CONC) to require debt management firms to give new customers details about the availability of FSCS cover for a

<sup>63</sup> 'Debt management activity' and 'debt solution' are as defined in our Handbook Glossary.

<sup>64</sup> See COMP 5.2.1R in Appendix 1.

<sup>65</sup> 'CASS debt management firm' is defined in our Handbook glossary with reference to our rules on client assets, which are set out in our Client Assets Sourcebook (CASS).

<sup>66</sup> See Comp 5.8 in Appendix 1.

shortfall in client money and also provide this information in their financial promotions and other communications.

### **Debt management: how to fund FSCS coverage**

- 9.12** We propose to create a new debt management claims funding class. This will be funded by commercial debt management firms and consumer credit firms with specific lending permissions. This class will contribute to the base costs levy, the specific costs levy and the compensation costs levy.
- 9.13** We do not propose to require not-for-profit debt advice bodies, which undertake the relevant debt management business, to contribute to the new funding class, apart from paying a contribution to the base costs levy, which all firms contribute to. We believe this would minimise the overall financial and administrative burden on these not-for-profit firms, both in terms of reporting data to us and the direct cost of a levy. We believe this is proportionate, given how not-for-profit firms are structured and financed, and avoids resource being taken away from their services to consumers. It is also consistent with the fact that not-for-profit debt advice bodies do not generally pay FCA fees or contribute to the FOS levies in other sectors.
- 9.14** We have completed initial affordability calculations, and believe that the new debt management claims funding class would be unsustainable if it was funded only by the relatively small number of debt management firms. For this reason, we propose to include consumer credit lenders<sup>67</sup> within the funding class. We believe these contributions are justified because these firms are often the creditors of clients of debt management firms. As such, the lending practices of consumer credit lenders may have been part of the reason the client ended up seeking the services of a debt management firm in the first place. We will not require firms with consumer hire permissions, such as those offering hire purchase agreements, to contribute because they do not usually involve these kinds of debts.

**Q19: Do you agree with our proposals to include protection for client money for debt management activities within the scope of FSCS protection and our proposed funding arrangements?**

**Q20: Do you have any views on whether or not coverage should be extended to negligent advice provided by debt management firms?**

## **Structured deposits**

### **What are structured deposits?**

- 9.15** Structured deposits are a type of deposit which differ from traditional deposits or savings accounts. They are similar to structured investment products, which give investors the opportunity to achieve greater returns by linking their performance to particular stock market indices over a fixed term. Structured deposits guarantee investors the full return of their initial deposits, while the remaining 'structured payoff' depends on how well the underlying investments have done.

<sup>67</sup> By consumer credit lenders we mean firms with permission for at least one of the following permissions: entering into a regulated credit agreement as lender; and exercising, or having the right to exercise, the lender's rights and duties under a regulated credit agreement.

**9.16** Structured deposits are held by deposit-takers like banks and building societies. FSCS protection is already available for claims for eligible deposits under the PRA's depositor protection rules (currently up to £75,000)<sup>68</sup> if a deposit-taker fails. However, firms – including deposit-takers – can advise on, arrange and sell structured deposits to investors. This means investors can be at risk of mis-selling if, for example, they have been wrongly advised about the suitability of the particular investment risk or its term and liquidity. Currently, investors are not able to claim against the FSCS for these intermediation activities.

#### **Extending FSCS protection to structured deposits**

**9.17** As part of implementing the new MiFID II, we are currently consulting on increasing the requirements for firms that advise on and sell structured deposits.<sup>69</sup> However, we believe it is proportionate to increase the scope of the FSCS to include these products.<sup>70</sup>

**9.18** The Government has proposed amendments to a number of investment-related regulated activities to transpose into law the activities in MiFID II of 'selling' and 'advising' clients on structured deposits.<sup>71</sup> The proposed relevant regulated activities, in the Regulated Activities Order (RAO), which will include structured deposits, are:

- dealing in investments as agent (Article 21)
- arranging deals in investments (Article 25(1))
- making arrangements with a view to transactions in investments (Article 25(2))
- managing investments (Article 37), and
- advising on investments (Article 53)

**9.19** We propose to extend the scope of FSCS cover to allow investors to claim if they suffer loss from a structured deposit because a firm which has subsequently been declared in default wrongly advised them or sold them a structured deposit. This would, for example, allow the FSCS discretion to compensate an investor for the return on a structured deposit which they would have received if their money had been placed in the correct structured deposit. This will help protect investors from losses as a result of poor advice, in addition to the current protection they have under the PRA's rules for any loss of their eligible deposit.

**9.20** These proposals would give FSCS protection to any advice on structured deposits by a firm, whether or not it is a deposit-taker. Deposit-takers also sometimes undertake direct sales of structured deposits. So we also propose to extend FSCS cover to any sales of structured deposits by a deposit-taker, as well as to sales of structured deposits by firms where the relevant product is not provided by the firm arranging the sale. This will help ensure that there is equal protection available – consumers who purchase structured deposits directly from a deposit-taker will not be at a disadvantage compared to consumers who use an intermediary.

**9.21** We propose that funding FSCS coverage for intermediation of structured deposits is done by adding the activity to the Investment Intermediation funding class (Class D2) except for

<sup>68</sup> On 21 November 2016, the PRA opened a consultation to reset the deposit protection limit at £85,000. The PRA proposes that depositors will be protected up to £85,000 as of 30 January 2017. The consultation closes on 16 December 2016. Until the proposals are implemented by a PRA Board instrument, the deposit protection limit remains at £75,000

<sup>69</sup> CP16/29 *Markets in Financial Instruments Directive II implementation – Consultation Paper III* (September 2016)

<sup>70</sup> The transposition of MiFID II does not require FSCS cover to be extended to the intermediation of structured deposits. We therefore have discretion as to whether to extend FSCS cover to such activities.

<sup>71</sup> Annex C to HM Treasury's consultation paper, *Transposition of the Markets in Financial Instruments Directive II* (27 March 2015).

managing investments in relation to structured deposits, which we propose to add to the investment provision class (Class D1). We also propose to add this activity to reporting through the RMAR where it falls within Class D2. Possible future changes to funding arrangements, including for intermediation of structured deposits, are discussed in Chapter 7.

**Q21: Do you agree with our proposals to extend FSCS protection to structured deposits intermediation and to fund it through the Investment Intermediation and Investment Provision classes?**

### Fund management and collective investment schemes

**9.22** We propose to amend our rules to bring consistency to the circumstances in which the FSCS can compensate CIS consumers if an authorised fund manager or depositary is declared in default. Currently, only some of the CIS activities of fund managers and depositaries can be compensated under our rules.

**9.23** FSCS compensation for a protected type of claim is generally only available if the claimant has a valid civil claim against the defaulting authorised fund manager or depositary.<sup>72</sup> In practice, an eligible claimant is unlikely to have a valid civil liability claim if their loss is due to the failure of, for example, a CIS in the form of an investment company with variable capital (ICVC) and where fund managers do not have a direct contractual relationship with investors. We propose to close this gap by allowing the FSCS to ‘look through’<sup>73</sup> a claim by a CIS (or any intervening fund operators, managers, depositaries or trustees) against an authorised fund manager or depositary in default, to enable it to compensate the underlying CIS participants.

#### What are collective investment schemes?

**9.24** A CIS means any arrangements:

- that involve property of any description, including money
- where those taking part in the scheme participate in or receive profits or income from the property
- where the participants do not have day-to-day control over the management of the property, and
- where property is pooled or managed as a whole by, or for, the CIS operator<sup>74</sup>

The definition of what constitutes a CIS is clearly broad and can include a wide range of investments and structures. These can range from an authorised unit trust (AUT) with retail investors to an unregulated CIS conducted through an offshore limited partnership.

**9.25** We have considered what types of investment structures the FSCS should cover, and decided it should cover CISs, including those which are unit trusts, ICVCs and limited liability partnerships

<sup>72</sup> COMP 3.2R requires there to be a ‘claim’, which is then defined in the FCA Handbook Glossary as being: “...a valid claim made in respect of a civil liability owed by a ‘relevant person’ to the claimant”.

<sup>73</sup> By ‘look through’ in this context we mean treating a participant in a CIS as the claimant.

<sup>74</sup> CISs are defined in s235 of FSMA. The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001, SI 2001/1062, specifies arrangements that do not amount to CISs.

(LLPs). We do not propose to extend FSCS protection to those alternative investment funds (AIFs) which are not CISs, as we do not believe this is needed.<sup>75</sup>

### **FSCS protection for fund management and depositaries**

- 9.26** At present, the FSCS must treat underlying beneficiaries, rather than the actual claimant, as having the claim in certain cases. These include cases involving bare trustees,<sup>76</sup> nominee companies<sup>77</sup> or trustees of money purchase pension schemes.<sup>78</sup> We propose to provide a similar 'look through' for CISs so that, in certain circumstances, the FSCS can treat participants in the relevant fund as having a claim, instead of the CIS, operator, trustee, manager or depositary who is the actual claimant.
- 9.27** Under this proposal, authorised CIS fund managers and depositaries whose participants qualify as eligible claimants and who do not currently pay, or pay reduced, levies will start to pay higher levies. We will continue to require fund management firms to contribute to FSCS funding, based on their annual eligible income from fund management activities.

### **Q22: Do you agree with our proposed approach to provide FSCS protection for claims relating to fund management?**

### **Lloyd's of London**

- 9.28** If an FSCS funding class's levy limit is exceeded, insurers can currently be called upon to contribute to the 'retail pool'. If high compensation and specific costs in an FCA funding class mean it breaches this threshold, then funding from other firms is needed and in some cases insurers and other product providers would be called upon to contribute.
- 9.29** We propose to include the Society of Lloyd's within the retail pool. In Appendix 1, we have included a draft rule to achieve this and ensure we could collect appropriate contributions from Lloyd's if the retail pool was triggered. We are consulting on this change because it could be argued that it would be unfair for other insurers to have to cover claims if a Lloyd's broker failed, unless Lloyd's could also be called upon and make a proportionate contribution based on its share of the eligible insurance market. We propose to amend our rules to enable the FSCS to levy the Society of Lloyd's an amount that represents the aggregate of the levies that its members would have been required to pay if the FSCS levied them directly.
- 9.30** As mentioned in chapter 11, we also propose to change the tariff base for the insurer classes in the retail pool to the tariff base in the PRA's Policyholder Protection rules. This proposal has the benefit of aligning the insurers' FSCS levies under the PRA's rules with any retail pool levies on insurers under the FCA's rules. Any retail pool levy on Lloyd's would therefore be calculated on the basis of the tariff contained in the PRA's compensation rules. We also propose an amendment to the reporting rule (FEES 6.5.13R) to ensure that Lloyd's provides the FSCS with the information it needs to enable it to calculate any levy to be paid by Lloyd's.
- 9.31** It is also worth highlighting an additional potential implication of this proposal for the future. In Section 2, we suggested that authorised product providers could contribute towards

<sup>75</sup> See further discussion in FSA CP13/9 Implementation of the Alternative Investment Fund Managers Directive (Part 2) (March 2013)

<sup>76</sup> This refers to a 'simple trust' where the beneficiary is entitled to both income and capital.

<sup>77</sup> COMP 12.6.2R states that: 'If a claimant has a claim as a bare trustee or nominee company for one or more beneficiaries, the FSCS must treat the beneficiary or beneficiaries as having the claim, and not the claimant'.

<sup>78</sup> COMP 12.6.2AR.

intermediary claims routinely, rather than only when the retail pool is called upon. If we were to go ahead with such a proposal, this would also affect Lloyd's.

**Q23: Do you agree with our proposed new approach to Lloyd's of London?**

**Other proposed changes to our Handbook**

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- 9.32** We also propose a number of other minor changes, including removing PRA material that remains in our Compensation Sourcebook, our Fees Manual and other related parts of our Handbook. This material used to be in the PRA's Handbook and does not form part of the FCA's Handbook.
- 9.33** Other proposed minor amendments in Appendix 1 include changes to simplify or improve our rules. In particular, we propose to delete certain provisions in our Compensation Sourcebook (COMP 6.2.2G and COMP 1.4) because the contents are adequately covered elsewhere (in COMP 14). We also propose to delete the definition of 'professional indemnity insurance contract' because it is not needed.

## 10. Risks and responsibilities: reporting requirements

- 10.1** In Section 2, we opened up discussion about ways in which the levies a firm pays could better reflect the specific risks it poses to the FSCS. We are interested in learning more about the specific risks that firms pose in the distribution of higher risk investment products. To support our research, this chapter puts forward specific proposals to introduce additional reporting requirements.

### Our proposals for collecting data

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- 10.2** We propose to introduce new firm data requirements to help us identify which firms distribute higher risk investment products and how much of their annual income comes from this activity. We propose to collect this information through the Retail Mediation Activities Return (RMAR).<sup>79</sup> This information would support our ongoing supervision of the area, help us build a more comprehensive understanding of the current market and give us the practical data we need to assess how we should calculate a future levy premium, including the amount each individual firm should pay.
- 10.3** We accept that not all intermediary firms will have the relevant permissions to distribute higher risk investment products. Given this, our proposed new reporting requirements will not apply to firms which only provide non-investment insurance, pure protection and home finance intermediation. Instead, the new requirements would affect firms with one or more of the following permissions:
- dealing in investments as an agent
  - arranging (bringing about) deals in investments
  - making arrangements with a view to transactions in investments
  - advising on investments, and
  - advising on pension transfers and pension opt-outs
- 10.4** The new data requirements will be practical, proportionate and cost-effective, as we propose to introduce only two questions. We would add these to the return required from relevant intermediary firms for the FSCS levy.<sup>80</sup>

<sup>79</sup> This information would be collected through the RMAR where a firm is required to make a return for the purposes of the FSCS levy. For intermediary firms that are not subject to RMAR reporting requirements, we will collect this information through the same paper form these firms already use to submit their annual eligible data to us.

<sup>80</sup> We propose that this will form Part 2 of the RMAR which is set out in SUP 16 Annex 18AR.

1. *Do you offer, recommend or sell any of the following investments?*
    - *non-mainstream pooled investments*
    - *non-readily realisable securities*
    - *contingent convertible instruments*
    - *CoCo funds, or*
    - *mutual society shares*
  2. *If the answer to Q1 is yes, please state how much of your annual eligible income<sup>81</sup> derives from the business listed above?*
- 10.5** To help firms answer these questions, we would add instructions to the online form<sup>82</sup> to make it clear which firms should complete them. We are also consulting on Handbook guidance on completing the questions.<sup>83</sup>

### Considering alternative approaches

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- 10.6** As an alternative to introducing a new reporting requirement, we considered trying to identify firms that distribute higher risk products in other ways. For example, we considered we could make changes to our permissions regime to identify these firms. However, our view is that the practical arrangements of amending the permissions of all firms which advise on or arrange investments or life and pensions products would make it a less cost effective and proportionate approach, and much less flexible in responding to possible future risks.
- 10.7** More generally, we recognise that a risk-based premium or discount related to a firm's FSCS levies is not the only way we could respond to higher risk products. We have already highlighted the various steps that we have taken to tackle problems posed by sales of NMPIs. More generally, we can, and do, employ a range of different regulatory protections in tackling problems such as mis-selling of higher risk products. We may consider introducing further policy restrictions or continue to increase supervisory activity in this area.

### **Q24: Do you agree with our proposal for a new reporting requirement on higher risk products in the RMAR?**

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81 Part 3c and 4c in Part 1RMAR Section J.

82 Part 2 of Gabriel RMAR Section J

83 At SUP 16 Annex 18 BG

# 11.

## Funding classes and the levy year: specific proposals

- 11.1** In this chapter we set out a number of specific, technical proposals to change the way that the current funding arrangements work. In particular, we are proposing a change to align the time periods over which we collect different levies. We also explain how, in practice, we propose to incorporate intermediation of structured deposits and consumer credit within the FSCS funding arrangements.

### Direct debits and credit facilities for firms

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- 11.2** In Section 2, we discussed a range of options for smoothing firms' levy payments. One option was to introduce payment by quarterly direct debit. The possibility of spreading costs in this way is already envisaged in our Handbook,<sup>84</sup> but we do not currently operate quarterly direct debits on behalf of the FSCS. We do operate an automated annual direct debit facility, which allows firms to pay their invoice in one payment within 30 days of receipt of the bill.<sup>85</sup>
- 11.3** Introducing payment by quarterly direct debit would be complex due to a number of operational issues. The FSCS levy is included on an invoice with fees from six other regulatory organisations, including the FCA. As none of these other organisations is set up to receive payment by quarterly instalments, separating out the FSCS levies would potentially be very expensive – and these costs would need to be borne by the levy payers using the new direct debit service.
- 11.4** At the same time, it is unclear that we could actually secure significant benefits for levy payers by introducing quarterly direct debits. In the past, just over 20% of firms (4,000 of 18,000 firms contributing to the FSCS levy) chose to use a financing facility provided by a single firm which allowed them to pay their entire regulatory bill in monthly instalments. A wide range of firms currently offer these credit facilities and we have no reason to expect the proportion of firms seeking and using credit in this way has changed. We also have evidence that these firms would not be better off paying their levies by quarterly direct debit (especially given the additional costs of doing so) than they are in using credit facilities from third parties to spread the costs.
- 11.5** Given the costs of implementing a service to pay the FSCS levy in quarterly direct debits and the uncertain benefits for firms, we are not pursuing this approach. Instead, we propose to remove the rules in our Handbook<sup>86</sup> that appear to allow firms to pay their FSCS levies by quarterly direct debits, to avoid confusion. However, we recognise that there may be alternative options to consider and we would welcome views.

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<sup>84</sup> FEES 6.7.1R (2).

<sup>85</sup> Using this service reduces administration costs for firms and the FCA and approximately 25% of firms already use it.

<sup>86</sup> FEES 6.7.1R(2) and FEES 6.7.4R.

**Q25: Do you agree with our proposal to remove the rule relating to paying FSCS levies by quarterly direct debits or should we consider the options?**

### Incorporating consumer credit

- 11.6** As discussed in Chapter 9, we propose to introduce a new debt management funding class.
- 11.7** We propose to calculate the tariff base for firms with relevant lending permissions by using the total annual amount lent by the firm under its regulated credit agreements, or where it is not the lender, under the total amount lent under the regulated credit agreements to which those rights relate. We already have arrangements to collect these data for other purposes, so no additional data gathering requirements are necessary. We would calculate the tariff base for commercial debt management firms by using the annual total value of that firm's relevant debts under management,<sup>87</sup> but only where they are from a credit agreement.<sup>88</sup> We will ask commercial debt management firms to report this data annually via the annual written return that firms not subject to the RMAR currently submit.
- 11.8** We propose to set the threshold for contributions in this class at £45m. This is a combined threshold that includes contributions both from consumer credit lenders and from commercial debt management firms.

**Q26: Do you have any comments on our proposed class threshold and tariff measures for the new debt management claims class?**

### Incorporating the intermediation of structured deposits

- 11.9** We propose to extend FSCS protection to the intermediation of structured deposits. We therefore propose to include the intermediation of structured deposits within the current Investment Intermediation class (Class D2), apart from managing investments for structured deposits, which we propose to add to the investment provision class (Class D1). We are consulting on draft rules to achieve this. We will calculate levy contributions as a percentage of these firm's annual eligible income from their relevant intermediation activities but, if the firm is selling its own structured deposits, we propose a levy based on 7% of the firm's total structured deposits as a proxy for annual eligible income. This is broadly consistent with a similar calculation for insurance contributions. These activities would include arranging, advising, managing and dealing as an agent in structured deposits.
- 11.10** Where we propose to levy the intermediation of structured deposits within the Investment Intermediation class, they could be included in a merged Intermediary Claims class in future. Similarly, if we take this approach and introduce provider contributions then investment providers and deposit-takers (in relation to the direct sales of structured deposits) could be required to contribute to intermediary claims. In this scenario, we could potentially calculate deposit-takers' contribution as providers by using the tariff base in the Depositor Protection

<sup>87</sup> 'Relevant debts under management' are defined in the FCA's Handbook Glossary as "a debt due under a credit agreement or a consumer hire agreement in relation to which the firm is carrying on debt adjusting or an activity connected to that activity."

<sup>88</sup> CONC 10.2.6R, CONC 10.2.7G and CONC 10.2.10G.

part of the PRA's rules (ie covered deposits), but only where it relates to structured deposits – and we would need to collect this information.

**11.11** We have used these figures to illustrate our options for reforms to the class structure in Section 2 and we have assumed that provider contributions for the structured deposits category would be limited to £5m. This is because there are currently only a limited number of structured deposits in the market, which restricts potential losses to investors, while recognising the market may possibly expand in the future. We could revise this assumption before consulting on any rule changes in future and would welcome comments on it in the meantime.

**Q27: Do you have any comments on our proposed tariff measures and metrics for calculating the deposit taker contribution for direct sales in relation to structured deposits?**

**Q28: Do you have any comments on how, in future, we might calculate any provider contributions required from deposit-takers, in relation to structured deposits, if we were to consult in detail on this approach?**

### Tariff measures

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**11.12** More generally, we are not proposing any changes to the current tariff bases that determine firms' proportions of FSCS levies. The exceptions will be deposit takers' and life and general insurers' contributions to the retail pool where we will amend our approach to bring it into line with that of the PRA, so that firms only need to report one dataset. The tariff base for deposit takers is set out in the Depositor Protection part of the PRA's Rulebook and the tariff bases for insurers (classes B1 and C1) are set out in the Policyholder Protection part of the same Rulebook.

**Q29: Do you have any comments on our decision to maintain the current tariff measures, except for deposit acceptors and life and general insurers?**

**Q30: Do you have any comments on our proposal to bring the tariff bases for insurers into line with the PRA's approach?**

### Aligning the levy time period

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**11.13** An issue for both the FSCS and firms is that the FSCS compensation levy year runs from 1 July to the following 30 June.<sup>89</sup> However, while the separate management expenses levy is paid together with the compensation costs levy, it is calculated from April to March. These different time periods complicate the levy forecasting for FSCS and make it difficult for firms to budget for the levy.

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<sup>89</sup> The compensation levy year is from July to June because, while the FSCS generally announces the amount of the levy each April, a firm only actually pays it around July.

- 11.14** To align the time periods of the FSCS compensation costs levy and management expenses levy, the FSCS needs to have enough funds available to cover potential compensation payments between the time the levy year starts in April and receiving the funds in July. One option is to require those firms already paying FCA and PRA fees on account to do the same for the FSCS levy levies. This would mean these firms will pay up to 50% of the previous year's FSCS levy on account in April to bridge the gap that would otherwise be created. The remaining balance for firm's FSCS levy for the current year would be due in September. This would be easy to administer, as it would only apply to firms already making payment on account for their FCA and PRA fees. Introducing payment on account also spreads costs more evenly across the industry as firms currently paying on account do not make any levy payment until the second payment is due in September, while firms not paying on account pay their FSCS bill in July. Aligning the compensation levy timing to start in April would help both firms and the FSCS with planning.
- 11.15** The percentage that the FSCS could ask firms to pay on account needs to be flexible; the FSCS compensation costs levy is less predictable than other regulatory fees because it is based on actual or anticipated compensation requirements. In general, we propose that firms pay 50% of the previous year's FSCS levy on account towards their FSCS levy due for the current year. The FSCS would have the option to reduce this percentage according to their expected requirements, or collect no payment on account at all if they did not expect any requirement between April and June. If the FSCS anticipated that the amount firms must pay was less than 50%, they would expect to announce this in the preceding January alongside the announcement of the indicative compensation costs levy. If firms ever paid more on account than their total final FSCS bill, the September payment would be adjusted and the money refunded to firms accordingly.

**Q31: Do you agree with our proposal to require firms that, must pay some of their FCA/PRA levies on account to also make a payment on account in respect of their FSCS levy?**

## 12. Next steps

- 12.1** We expect to publish a further CP in the second half of 2017. It will contain:
- responses to the feedback we receive
  - made rules for the areas consulted on in detail in this paper, and
  - detailed policy proposals for consultation on other areas
- 12.2** Rules consulted on in this paper should be made in time for implementation in the 2018/19 financial year (or, for MiFID II implementation, from 3 January 2018). This timing reflects the need for finance and systems changes, following on from any changes to the structure of FSCS funding, which require significant lead time.
- 12.3** Further rule changes on FSCS funding (and any rules relating to PII) will therefore be made in time for implementation in the following financial year, 2019/20.

# Annex 1

## List of questions

### Questions for discussion

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- Q1:** Do you agree with the introduction of risk-based levies? Should we also consider other regulatory responses?
- Q2:** Do you believe that risk-based levies could be appropriate in relation to: a) higher risk investment products; b) insurance brokers that choose to place business with unrated insurers; and c) any other types of specific products or services?
- Q3:** Do you agree in principle that product providers should contribute towards FSCS funding relating to claims caused by intermediary defaults?
- Q4:** Do you have any views about the current effectiveness, or otherwise, of PII cover including in reducing the number and cost of claims on the FSCS, and about the role of PII in providing compensation to consumers who have claims against failed firms?
- Q5:** Do you have any views or suggestions about the possible features of more comprehensive, mandatory PII insurance? Do you have any suggestions about other possible tools, remedies or approaches which could be used to reduce the scale of funding currently required by the FSCS?
- Q6:** Do you have any views on the impact of a requirement on PIFs to hold more comprehensive PII? For example, what would be its impact on the PII market, the financial advice market and on consumers in general?
- Q7:** Would you support an increase to the FSCS compensation limit in relation to any or each of the investment provision, investment intermediation and life & pensions intermediation classes? If so, do you have any views on what those limits should be?

- Q8:** Would you support a proposal to differentiate between investment provision and investment intermediation, and to introduce higher limits for either? If so, do you have any views on what those limits should be?
- Q9:** Would you support a proposal to seek to make a distinction between pensions-related investment business and non-pensions investment business, and apply higher limits for pensions-related investments? If so, do you have any views on how the distinction might be made and what those limits should be?
- Q10:** Do you have any comments about the possible risks to investors posed by crowdfunding and whether these might justify introducing FSCS protection?
- Q11:** Do you have any comments about the scope of the FSCS and whether promoting financial products, or any other activities, should be included within its coverage?
- Q12:** Do you agree that it would not be justified for the FSCS to utilise a credit facility to further smooth levies, given the costs involved?
- Q13:** Do you believe that we should seek to reduce the number of funding classes, in order to reduce volatility of FSCS levies?
- Q14:** What are your views on the different funding classes we have set out here? Do you have any alternative proposals?
- Q15:** Do you agree with our intention to keep the current class thresholds for intermediary classes, merging the thresholds if appropriate to adopt a revised class structure?
- Q16:** Do you agree with our intention to keep our current class threshold of £200m for the investment provision class?
- Q17:** Do you have any views on the idea of a fixed levy for smaller firms?
- Q18:** Do you have any comments on the mechanism by which we would propose to incorporate product provider contributions into the intermediary claims classes, for the various different class structure options described?

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### Questions for consultation

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- Q19:** Do you agree with our proposals to include protection for client money for debt management activities within the scope of FSCS protection and our proposed funding arrangements?
- Q20:** Do you have any views on whether or not coverage should be extended to negligent advice provided by debt management firms?
- Q21:** Do you agree with our proposals to extend FSCS protection to structured deposits intermediation and to fund it through the Investment Intermediation and Investment Provision classes?
- Q22:** Do you agree with our proposed approach to provide FSCS protection for claims relating to fund management?
- Q23:** Do you agree with our proposed new approach to Lloyd's of London?
- Q24:** Do you agree with our proposal for a new reporting requirement on higher risk products in the RMAR?
- Q25:** Do you agree with our proposal to remove the rule relating to paying FSCS levies by quarterly direct debits or should we consider other options?
- Q26:** Do you have any comments on our proposed class threshold and tariff measures for the new debt management claims class?
- Q27:** Do you have any comments on our proposed tariff measures and metrics for calculating the deposit taker contribution for direct sales in relation to structured deposits?
- Q28:** Do you have any comments on how, in future, we might calculate any provider contributions required from deposit-takers, in relation to structured deposits, if we were to consult in detail on this approach?
- Q29:** Do you have any comments on our decision to maintain the current tariff measures, except for life and general insurers?
- Q30:** Do you have any comments on our proposal to bring the tariff bases for insurers into line with the PRA's approach?

**Q31:** Do you agree with our proposal to require firms that must pay some of their FCA/PRA levies on account to also make a payment on account in respect of their FSCS levy?

## Annex 2

# Cost Benefit Analysis

1. Under the Financial Services and Markets Act (FSMA), we are required to perform a cost benefit analysis (CBA) of our proposed rules (and guidance relating to rules). In this Annex we explore the costs and benefits associated with the proposals to changes in Handbook text that we are consulting on.
2. As explained earlier in this consultation paper, we are also publishing (in Annex 4) the detailed affordability analysis that we have performed to inform our proposals.

### Extending consumer protection: specific proposals

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3. In this section, we examine the costs and benefits of the proposals in Chapter 9.
4. **Debt management**  
Currently, a number of firms which provide debt management services who have held interim permissions are still in the process of undergoing our full authorisations procedure, like other firms within the consumer credit regime. This means that we do not yet know what the debt management market will look like when our proposed rules come into effect in 2018/19. However, some commercial debt management firms and not-for-profit debt advice organisations have already received full authorisation. We have examined our data on the amount of client money held by these debt management businesses, as well as data on the total amounts of debts under management by individual debt management firms.
5. We are consulting on rules that will extend FSCS cover to certain debt management activities carried on by debt management firms that hold client money, although only where the eligible claimant's claim is about a shortfall in client money. Debt management firms are required to deal with client money in accordance with our rules set out in CASS 11. We also propose that this extended cover is chiefly financed by FSCS levy contributions from commercial debt management firms and consumer credit lenders.<sup>90</sup>
6. To calculate the levy contributions by consumer credit lenders, we will refer to the amount of loans under the relevant regulated credit agreements. These are data which we do not currently collect. However, we have arrangements in place to start to collect these for other supervisory purposes, which we are expecting will be effective for our first calculations for the FSCS levy year 2018/19.
7. We are able to give an indication of the scale of the maximum levy contribution by consumer credit lenders to compensation costs if the FSCS declared a large debt management firm in default, incurring claims. We have calculated this by looking at the total client money held

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<sup>90</sup> We do not propose to require not-for-profit debt advice bodies, which undertake the relevant debt management business, to contribute to the new funding class, apart from paying a contribution to the base costs levy.

by one of the larger debt management firms, projecting a significant loss of client money as a result. We then shared this across all firms with one or both of the two relevant lending permissions. These permissions are: entering into a regulated credit agreement as lender and/or exercising or having the right to exercise, the lender's rights and duties under a regulated credit agreement. Based on this calculation, we believe that £45 million is a reasonable threshold for this class. This amount is significantly above the amount of the total client money currently held by any individual debt management firm. The average contribution per lender firm if a levy was at this threshold would be approximately 0.22% of annual income.

8. We propose that commercial debt management firms will make levy contributions which are calculated against the annual total value of their relevant debts under management. We will collect these data each year using a data return from individual firms. We recognise that this will have a cost to firms, but we expect these costs to be very low.
9. In terms of the benefits of providing protection to debt management customers, we believe that this is an important way to protect consumers who may be particularly vulnerable because of their debts and related difficulties. Not only could the consumer lose money held by the debt management firm, but they could also suffer consequences from not being able to pay their creditors.

#### **MiFID II: structured deposits**

10. We have limited information about the current amount and value of structured deposits in the market, although we are aware that there are only a few active providers. Despite this, we believe that this is a market which can fluctuate significantly and that additional protection is justified to safeguard against future investor losses. We currently propose to include this activity within the existing investment intermediation class and, for managing investments in relation to structured deposits, the existing investment provision class. Given current activity levels, we believe that the additional costs to firms will be minimal.

#### **Fund management and CISs**

11. The consequence of ensuring FSCS protection for fund management and CISs is that fund management firms and depositaries that currently either pay no or reduced levies – because they declare no eligible income – will start to pay higher levies, when levies are required. This will increase the available contributions to the investment provision class and provider contributions to relevant intermediary classes if we proceed with any option to require provider contributions. It will provide protection to consumers which we believe it was always the intention of the current rules to provide.
12. During 2016/2017 there were 464 firms that reported zero annual eligible income in the investment provision FSCS class SD01 out of a total of 1,062 – 43.7% (firms that hold the permission 'managing investments'). This gives an indication of the numbers of firms which are likely to make additional contributions. However, we do not have separate information about the amount of relevant business each individual firm undertakes, so cannot calculate their amounts of additional levy contribution.
13. The benefits of this proposed change will go to consumers who will be able to make a claim to the FSCS, and who would not be able to do so currently. We are not able to estimate these benefits because we have no way of predicting either future firm failures or whether claims resulting such failures would be covered under the current rules.

#### **Bringing Lloyd's of London into the current funding arrangements**

14. We are consulting on the rule changes to ensure that Lloyd's of London may be levied appropriately within the current funding arrangements so that, if the retail pool were triggered,

they would contribute appropriately. We believe that this is proportionate as other insurers are required to contribute in this way. We cannot estimate possible costs at this point as we do not currently collect relevant tariff data from Lloyd's. We do, however, note that to date there has not been a call on the retail pool and any call that Lloyd's faced would be calculated on an equivalent basis to calls on other insurers.

### **Risk and responsibilities: reporting requirements**

15. In this section, we examine the costs and benefits of the proposals in Chapter 10.

#### **Collecting data that could inform a risk based levy premium**

16. We are consulting on proposals to collect new information, largely through a new Part 2 of Section J of the RMAR.<sup>91</sup> We will collect this information from firms that are currently within the Investment Intermediation and Life and Pensions Intermediation classes with relevant permissions linked to retail distribution. We will use this information to identify which firms distribute, or carry out intermediation activities for, products that we consider may be 'higher-risk' and currently have retail distribution restrictions (for example, NMPs) and identify how much of their annual income this activity generates.

#### **Benefits**

17. FSCS data show that, between 2013 and 2016, approximately a third of the total value of FSCS claims was linked to the distribution of NMPs by the regulated advice sectors. Collecting these new data will help us develop future proposals to apply premiums on FSCS levies for firms distributing products we consider are 'higher-risk', either because they are linked to past FSCS claims or because they could potentially generate future claims. Our intended outcome is that those who advise on products or undertake activities that incur the greatest cost to the FSCS scheme should proportionally bear more of that cost.
18. The new data we collect will help us build a more comprehensive picture and give us the practical data to assess how we should calculate a future levy premium, and how this will affect the firm's levy. It will also help us monitor ongoing trends in the higher-risk product market and their impact on FSCS claims. As these products areas do not currently have to meet the same data-gathering requirements as more mainstream investments, our understanding of the riskier end of the investment product is less developed.
19. We have spoken to many industry trade associations who suggest we take a more active role in supervising firms that distribute higher-risk investment products. Some believe that an FSCS levy premium, combined with more active supervision of investment products which have a history of being mis-sold, might help reduce the overall size of the FSCS levy. However, these respondents have also said we need to consider the costs to firms of collecting such data on investment products.

#### **Costs**

20. The new data requirements will apply to an estimated 7,446 intermediary firms that have certain specified permissions. Intermediary firms that only carry out non-investment insurance business, pure protection business or home finance mediation business are excluded from the new requirements. We recognise the need to be proportionate and limit the cost impact on

<sup>91</sup> SUP 16 Annex 18AR

firms having to report under this proposal; we have limited the new data requirements to two questions.<sup>92</sup>

21. We have tried to identify a range of likely costs to firms during the proposed collection period. The new data requirements will affect all products which currently have retail distribution restrictions so we expect all firms will already have established processes in place to monitor the distribution of these products to customers. Nevertheless, we expect the processes for recording income from specific products to vary considerably across firms.
22. Based on discussion with industry stakeholders, we estimate the cost of collecting the data to be minimal. We have estimated, taking into account analogous FCA requirements, that it would take each firm between 5 to 14 hours to collect the new information dependent on the size of firm and other factors. Using the median gross hourly pay of employees in financial services from the Annual Survey of Hours and Earnings of £18.18 and adding non-wage labour costs and overheads of 30%, the hourly cost to firms would be £23.60. Using the range of hours above, this would result in a range of one-off costs to industry of between £880k to £2.46m in total.
23. Another way we aim to minimise any additional costs to firms is to ensure that the processes for firms reporting these additional data coincide with the existing processes for reporting eligible income data. We estimate 4,623 firms will submit the new data online through their Retail Activities Mediation Return. The remaining 2,823 firms that do not have to meet RMAR reporting requirements will be required to submit their data through a paper return. This is the same process through which we currently collect their annual eligible income data. Firms within this latter category include some financial advice firms, discretionary investment managers, credit unions, building societies, authorised professional firms, life insurers and banks.
24. We want to ensure that the premium is weighted proportionately to the amount of eligible income a firm generates through its higher-risk business activity. So, while this consultation paper outlines our approach to introducing a risk-based levy and proposes new data requirements to support it, it would be prudent for us to analyse at least a full year's data from firms before deciding whether to introduce a levy premium and then consult again on a proposal to introduce a levy premium and its precise computation. Our decision to introduce a premium will depend on us being satisfied with both the quality of the data we collect and the continued association between FSCS claims and higher-risk investment products.
25. We believe that a proposal to amend Section J of the RMAR to collect this new data at these stage is the most proportionate way of finding out which firms distribute higher-risk products.

### **Funding classes and the levy year: specific proposals**

26. In this section, we examine the costs and benefits of the proposals discussed in Chapter 11.

#### **Removing the option of payment by direct debit**

27. We do not currently implement the rules allowing firms to pay their FSCS levy in quarterly instalments by direct debit with the FSCS's permission.<sup>93</sup> We have explained the operational issues behind this in this consultation. Therefore, removing these rules from the Handbook has no cost impact on firms or regulators.

<sup>92</sup> As outlined in Chapter 10

<sup>93</sup> FEES 6.7.1R(2) and 6.7.4R

**Changing tariff bases**

28. Changing the tariff bases for firms in the deposit taker and insurer classes for the purposes of the retail pool will result in no additional costs to firms as they already report this information for the purposes of calculating PRA levies. The one exception to this is Lloyd's of London, which does not currently report any information for the purposes of FSCS levies. We are unable to estimate the cost which Lloyd's will incur but do not believe that these will be disproportionate compared to the costs already incurred by other insurers.

**Changing the levy year and introducing payment on account**

29. Including FSCS levy payments for the firms that already pay FCA and PRA levies on account will allow FSCS compensation and MELL levy years to be aligned.
30. To align the levy periods, the FSCS needs to have enough available funds to cover potential compensation payments between the time the financial year of the compensation scheme starts (1 April) and when funds are received from firms (generally in July).
31. A proportion of firms already pay some of their regulatory fees on account on 1 April each year. Accordingly, the proposal is to introduce a requirement that these same firms also pay a certain sum towards their FSCS levy on account on 1 April. The amount of the FSCS levy to be paid on account will be calculated as up to 50% of the FSCS levy they paid for the preceding financial year of the compensation scheme. Any balance will then be payable on the following 1 September.

**Cost to regulators**

32. There is no additional cost to include the FSCS portion of the regulatory levy in the amounts that are already paid on account. The systems are already set up to invoice and receive payments from an identified proportion of firms.

**Cost to firms**

33. Firms paying on account will be required to pay up to 50% of their FSCS levy six months earlier than they have been. However, this will only have an impact on firms for the first year. Once the first levy payment is adjusted, the first payments will continue to be 12 months apart.

**Benefits**

34. Providing the FSCS with funds from April each year, as opposed to July as currently, will enable the FSCS to align the FSCS levy years in the way we describe in Chapter 11. This will make it easier for firms and the FSCS to calculate and budget FSCS costs for the financial year of the compensation scheme.

## Annex 3

# Analysis of potential risk measures

1. The purpose of the analysis set out in this Annex is to identify those firms at greater risk of failing and leaving significant liabilities for the FSCS. It looks at the relationship between certain firm-specific risk measures ('metrics') and the generation of FSCS claims through firms exiting the market<sup>94</sup> (referred to in this annex as 'firm exits'). Our analysis uses two methodological approaches:<sup>95</sup>
  - A straightforward data analysis in the form of charts which is reported in this Annex.
  - A more complex, robust econometric analysis which quantifies the risk associated with these risk metrics. The detailed findings of which are available on request.
2. The combined results from this analysis indicate the following:
  - among the intermediaries,<sup>96</sup> four measures have some predictive power in terms of a firm's future exit. These metrics are liquidity ratio, excess capital to revenue ratio, FOS complaints and FSCS claims. Leverage ratio and return on assets do not have any statistically significant predictive power of a future exit.
  - among investment providers, liquidity ratio was the only metric with any predictive power of a future exit.
3. The analysis set out in this Annex does not explore the question of whether the measures identified as having some predictive power are suitable for setting FSCS levies. It does not consider the consequential impact of how a risk-based levy is designed. As we develop the proposals set out in Chapter 3, we will need to explore this question further to identify any unintended consequences such as any changes to firms' behaviour or hastening the exit of declining firms.
4. We consider a firm exit to be a necessary requirement before an FSCS claim can be generated. 'Live' firms can only generate a FOS complaint rather than FSCS claim. While live firms that are unlikely to be able to pay may be referred to FSCS, the firm would need to be declared in default before any claim is paid. Due to the low number of FSCS claims in the data, the econometric analysis cannot establish meaningful prediction estimates for the future. Instead, we study the predictive power of the metrics for firm exit. About one in ten firms exiting also generate a claim.

94 This refers to firms exiting from the FSCS and Retail Market Activities (RMA)-related markets

95 Further details about our econometric analysis are available on request

96 Intermediaries are a new class formed by combining GI intermediaries, L&P intermediaries, Home Finance Intermediaries, and Investment intermediaries.

## Methodology

5. We combined historical data on FSCS levies (fees), income and claims with RMAR and FSA data<sup>97</sup> on balance sheet items, income statement items, and other metrics. We studied the data for the period 2010/11 to 2015/16.
6. To understand what characteristics lead a firm to generate an FSCS claim, we have categorised the participant firms in the historical data into three groups:
  - firms that generated an FSCS claim in 2014/15 and, separately, in 2015/16
  - firms that exited<sup>98</sup> in 2014/15 and, separately, in 2015/16 but did not generate any FSCS claims, and
  - other firms – those that did not exit or generate any claims
7. We examined these three groups of firms against four risk-based measures and complaints data:
  - leverage ratio, defined as total capital and reserves<sup>99</sup> to total assets ratio<sup>100</sup>
  - liquidity ratio, defined as total current assets<sup>101</sup> to total assets ratio<sup>102</sup>
  - return on assets, defined as ratio of net income<sup>103</sup> to total assets,<sup>104</sup> averaged over two years
  - excess capital<sup>105</sup> to revenue<sup>106</sup> ratio
  - FCA complaints, and
  - FOS complaints
8. The first three measures are similar to measures used by the PRA for its proposed risk-based levy approach for credit unions.<sup>107</sup> They are also included in the European Banking Authority's guidelines for deposit guarantee scheme levy calculations.<sup>108</sup> The fourth measure, excess capital to revenue ratio, is based on our own analysis of possible metrics that indicate risky firms. The

97 RMAR only includes data on its regulated activity. This omits potential unrelated activity and the associated fiscal data. FSA data is used for the investment provision class instead of RMAR.

98 A firm is considered to have exited if we observe both its total assets and revenue (FSCS eligible income) to be zero. Some firms appear to only be dormant in one of the years in our data 2010-2016 but become operative (their revenue or capital turns positive) in a subsequent year. These are considered to be live firms. Note that this group may contain firms that are still active but no longer undertake FSCS-related activities. Non-regulated activities are however, not included (as per footnote 114).

99 RMA-A-21.

100 Sum of RMA-A-4 and RMA-A-10.

101 RMA-A-10.

102 Defined as at footnote 101 above.

103 RMA-B-12.

104 Defined as at footnote 101 above.

105 RMA-D1-10.

106 RMA-B-8.

107 PRA CP7/16, pp. 15-18. [www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp716.aspx](http://www.bankofengland.co.uk/pr/Pages/publications/cp/2016/cp716.aspx)

108 EBA/GL/2015/10, pp. 10-28. [www.eba.europa.eu/documents/10180/1089322/EBA-GL-2015-10+GL+on+methods+for+calculating+contributions+to+DGS.pdf](http://www.eba.europa.eu/documents/10180/1089322/EBA-GL-2015-10+GL+on+methods+for+calculating+contributions+to+DGS.pdf)

data shows that firms deplete their capital, both excess as well as total, before an FSCS claim is generated (see Figure 1 for more details).<sup>109</sup>

9. We employed two methodological approaches. First, we analysed the data with a visualisation method, by plotting these six metrics over time for the three groups of firms. We only did this for the intermediaries, where we observe FSCS claims. These data plots indicate at a high level how metrics evolve over time and how they differ for different firm groups. While these plots are more straightforward to understand and explain, they are unable to explain more complex questions, such as if there is any interaction between metrics themselves.
10. Second, we conducted analysis of firms which survived, which is a more complex econometric method. Its advantage is that it can add to, and explain the narrative in much more detail. For instance, it takes into account characteristics of the data and its distribution which we need to tell us whether the results are driven by chance or by systematic relationship in the variables. It can also pin down the extent to which a change in one metric leads to a higher risk – in this case, risk of a firm exit.
11. Given the low number of FSCS claims in the data (2% of all firms), we are unable to perform the econometric analysis for prediction of claims. Instead we studied the predictive power of the metrics for firm exit, as 20% of the firms exited at some point in the six year time period.

### Data sample

12. The data is a large sample of firms that are part of the FSCS retail pool. The FSCS collects data on eligible income to calculate levies, as well as data on claims against these firms. We have merged this dataset with the FCA's RMAR, which include information about firm's balance sheet items, income and cash-flow statement items, as well as other items such as the number of advisers.

### Intermediary firms

13. Our sample of intermediaries is taken from 17,841 FSCS intermediation firms over the 2010/11-2015/16 six-year period. Out of these, we can analyse 15,569 firms for which we have all six risk metrics. This includes 293 firms that have generated FSCS claims, and 3,135 firms which have failed or ceased being active for at least two or more consecutive years. Out of 2,556 firms for which we have data on FSCS claims, only 347 have been matched against RMAR data. Nevertheless, these 347 firms account for 77% of the number of claims and 87% by the value of claims in the six-year time span.<sup>110</sup> Given the relatively low number of firms, in the sample and in general, that generate an FSCS claim, the findings described in this Annex may vary significantly from year to year.
14. As well as the low number of FSCS claims every year, some observations are lost when RMAR and FSCS data is merged. The outcome is a subset of the data that accounts for 90% of claims, and approximately 70% of eligible income, with the exception of the investment provision class that we studied separately<sup>111</sup> (see Table 4 and Table 5). Firms that remain unmatched are mostly those that generated a claim in 2010/11.

<sup>109</sup> These metrics are based on firm-level measures. Owing to limitations with the data, which is not granular at the product level but aggregated at the firm level, it has not been possible to analyse risk at the more granularly (for instance for products whose sale is more prone to generate FSCS claims than other products). Product related risk is being analysed separately from this note.

<sup>110</sup> See Table 4 for details.

<sup>111</sup> Investment providers are typically larger firms that do not report to FCA for RMAR, rather they report to PRA which is collected in the 'FSA' datasets. Investment provision analysis is done separately below.

**Investment providers**

15. As there are a very low number of FSCS claims, it is not possible for us to conduct any analysis of claims-related risk for investment providers. However, we do observe 87 firms to exit the market during this time.

**Data analysis and visualisation – intermediaries**

16. The sections below present the data and the metrics for the three groups of firms above.<sup>112</sup> We plot the data over time to see how the metrics evolve. For example, the average leverage ratio is shown for the three groups, and we can compare if it was higher for firms that have exited than for those that did not across different years. This also allows us to spot any trends over time.

**Notation**

17. In the following sets of graphs, the notation below is used:
- '1st Claim 2014/15' refers to firms that generated an FSCS claim in 2014/15 but not previously
  - 'Exit in 2014/15' refers to firms that exit in 2014/15 but did not generate an FSCS claim
  - 'Other firms' refers to all other firms (ie those who did not exit)
  - '1st Claim 2015/16', refers to firms that generated an FSCS claim in 2015/16 but not previously, and
  - 'Exit in 2015/16' refers to firms that exit in 2015/16 but did not generate an FSCS claim

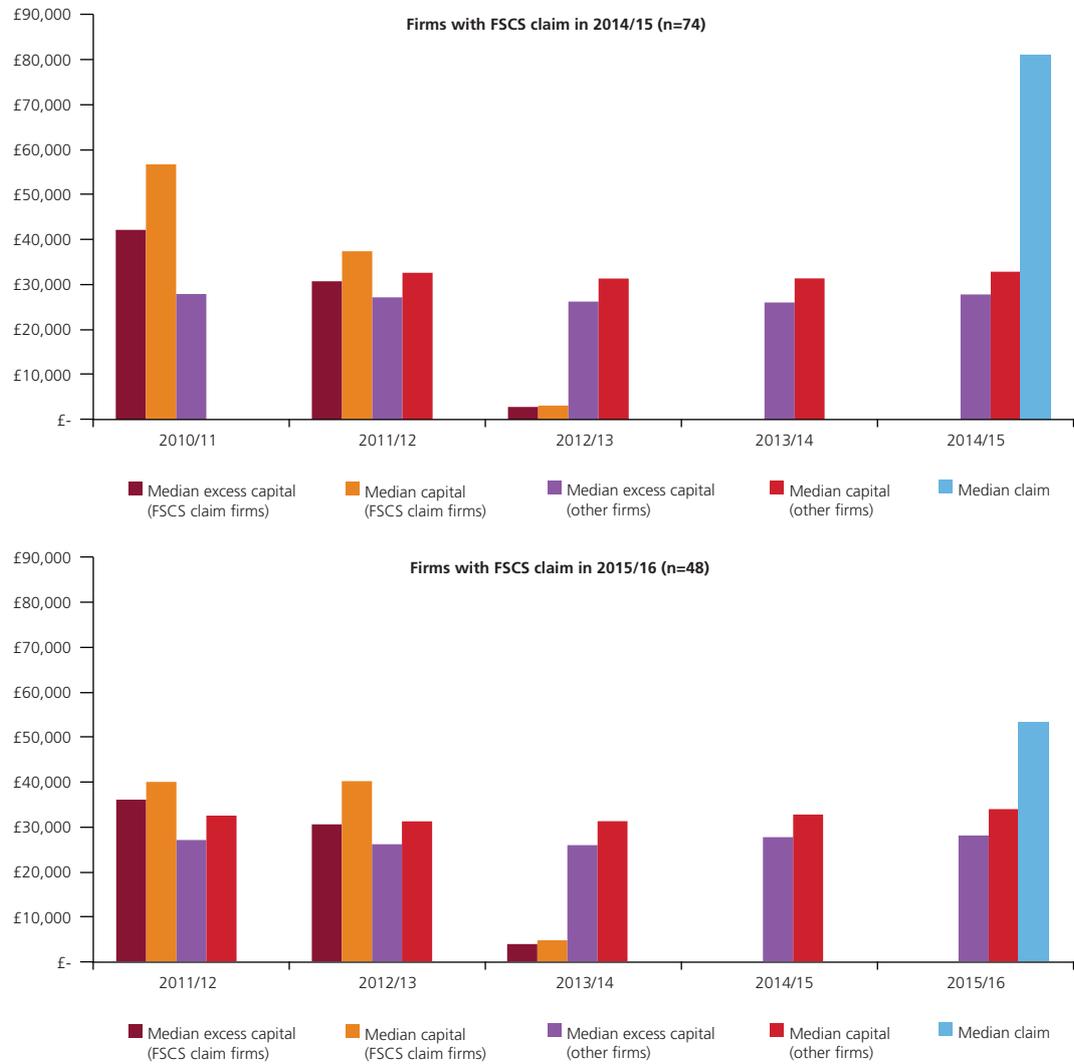
**Levels of capital and excess capital**

18. The graphs below show levels of capital and excess capital in 2014/15 and 2015/16 respectively.
19. The graphs show that the average firm that generates a claim depletes both its excess and total capital two years before the first FSCS claim is paid out. This holds both for firms that paid out their first claim in 2014/15 and those who paid out their first claim in 2015/16. For firms that did not generate claims, levels of capital and excess capital seem to remain more stable.
20. This suggests that capital, or lack of it, is an indicative measure of the risk of an FSCS claim. However, we note the smaller number of observations for firms generating claims in each of the graphs below.<sup>113</sup>

<sup>112</sup> The three types being firms in the data (i) that generate an FSCS claim, (ii) firms that exit and do not generate a claim, and (iii) firms that continuously operate throughout the time period covered.

<sup>113</sup> A small sample means that our findings are more prone to be driven by random fluctuations from year to year. However, at a high level looking at Figure 1 the charts are fairly consistent between the two years.

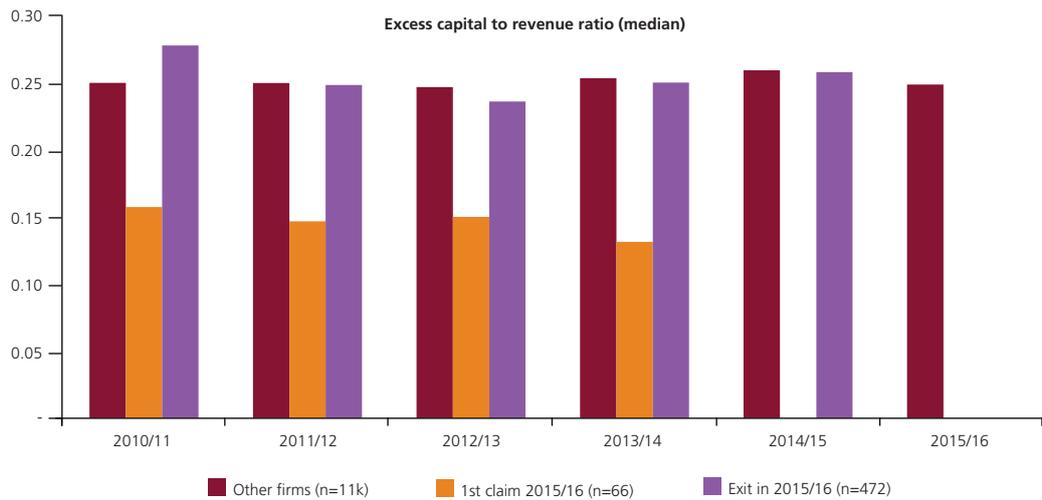
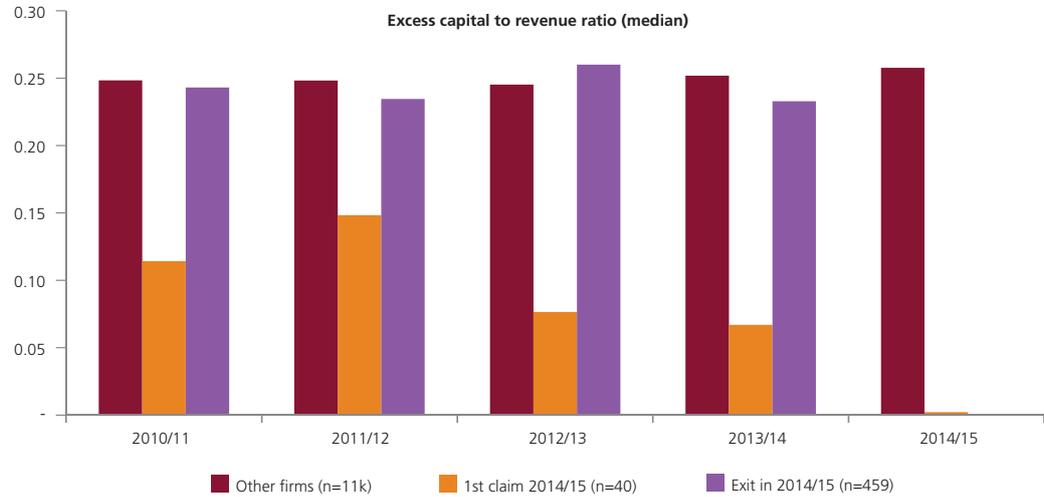
**Figure 1: Levels of capital and excess capital – comparison of firms generating a claim and other firms**



**Excess capital to revenue ratio**

21. For both 2014/15 and 2015/16 year groups there is a notable pattern that the median firm that generated an FSCS claim has a lower excess capital to revenue ratio compared to the median firm that exited, but did not generate claims, and compared to the median of other firms (those that did not exit). The ratios are very stable amongst firms that did not generate FSCS claims, so lower excess capital to revenue ratios may point towards firms more prone to generate an FSCS claim.

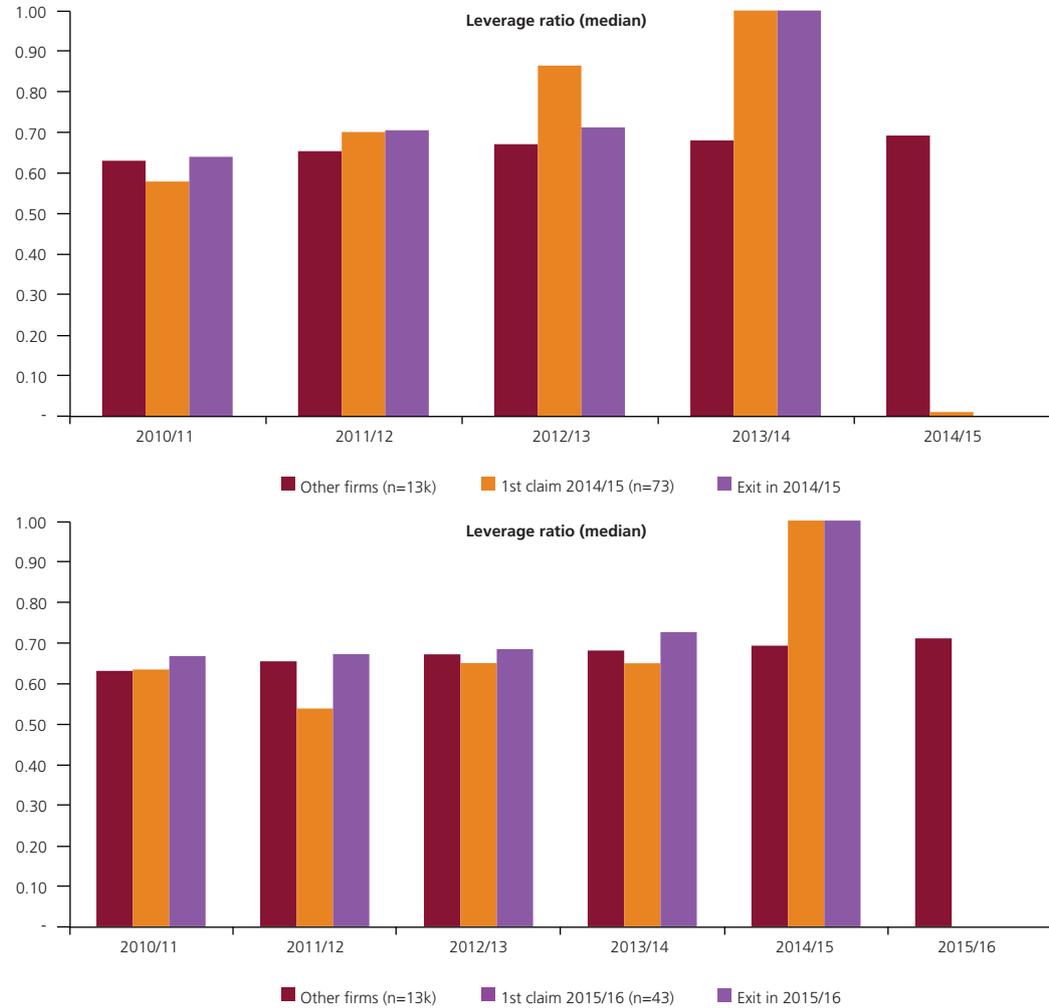
**Figure 2: Excess capital to revenue ratio**



**Leverage ratio**

**22.** For both 2014/15 and 2015/16 cohorts, the leverage ratio of the median firm that did not exit is stable over time at 60% to 70%. For the median firm that generated their first claim or exited the market in 2014/15 and 2015/16, there is an increase in leverage ratio in the year prior to the first claim or exit. As such, an increased leverage ratio may indicate a greater likelihood of exit but does not help to predict FSCS claims.

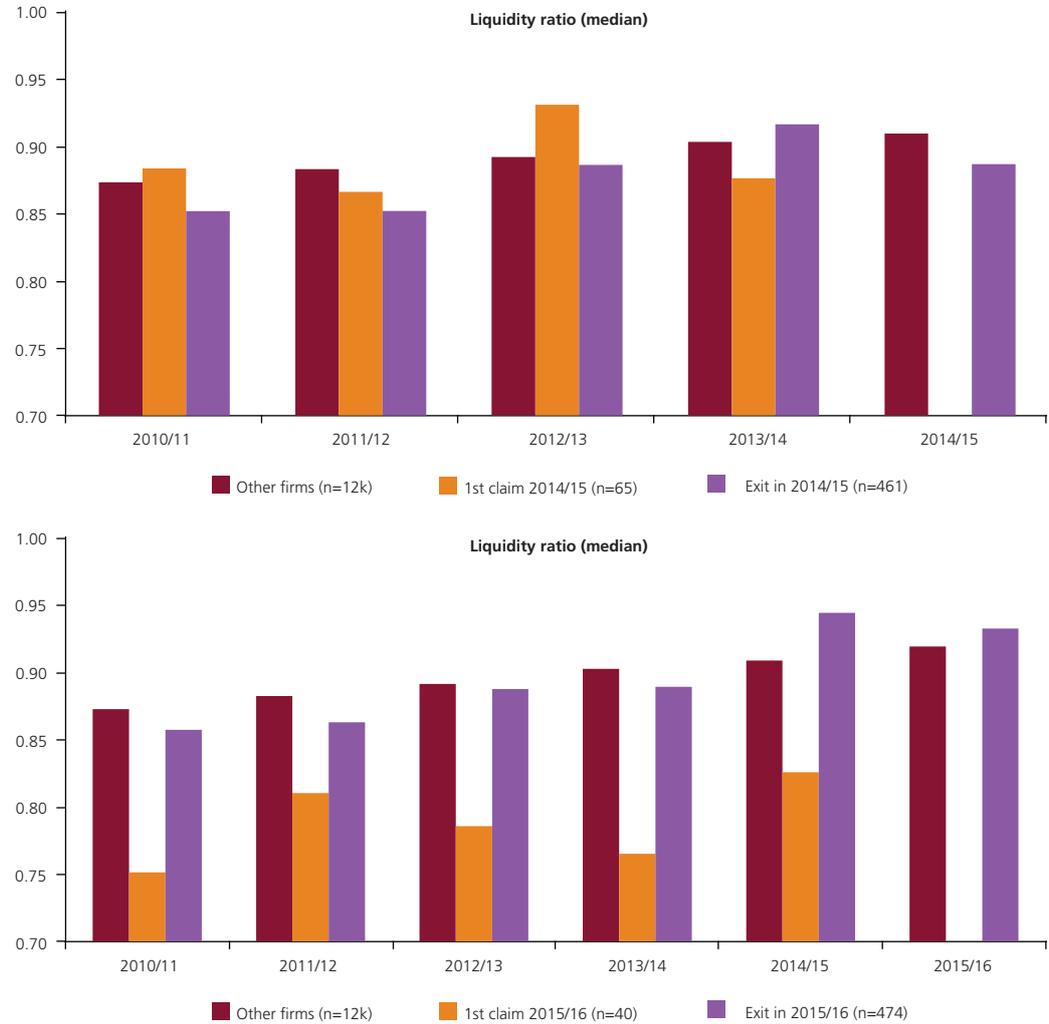
**Figure 3: Median leverage ratio**



**Liquidity ratio**

**23.** The results show the median firm whose first claim occurs in 2015/16 has a lower liquidity ratio compared to the median firm that does not generate claims. However, the first graph shows that this was not the case for firms whose first claim occurred in 2014/15. The difference between first claim firms in 2014/15 and 2015/16 demonstrates that there is no clear trend, making it difficult to draw strong conclusions from the data.

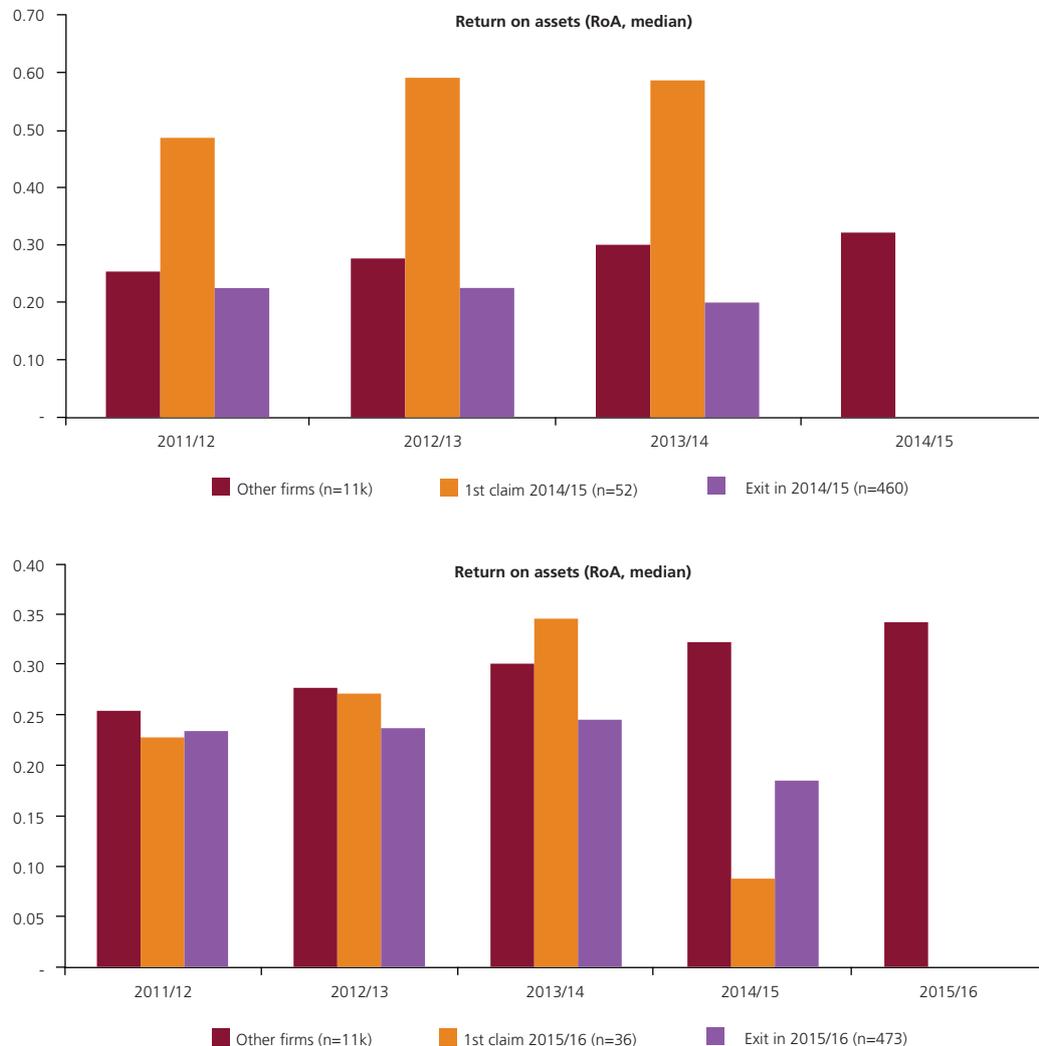
**Figure 4: Median liquidity ratio**



**Return on Assets (RoA)**

24. From the 2014/15 data there is some increase in RoA in the years leading up to a claim. It also appears that firms which generated claims have significantly higher RoA. However, neither of these observations are present in the 2015/16 data. The difference between the data for firms that generated a claim between the 2014/15 and 2015/16 year groups shows there is no obvious difference between firms that generate FSCS claims and those that do not.

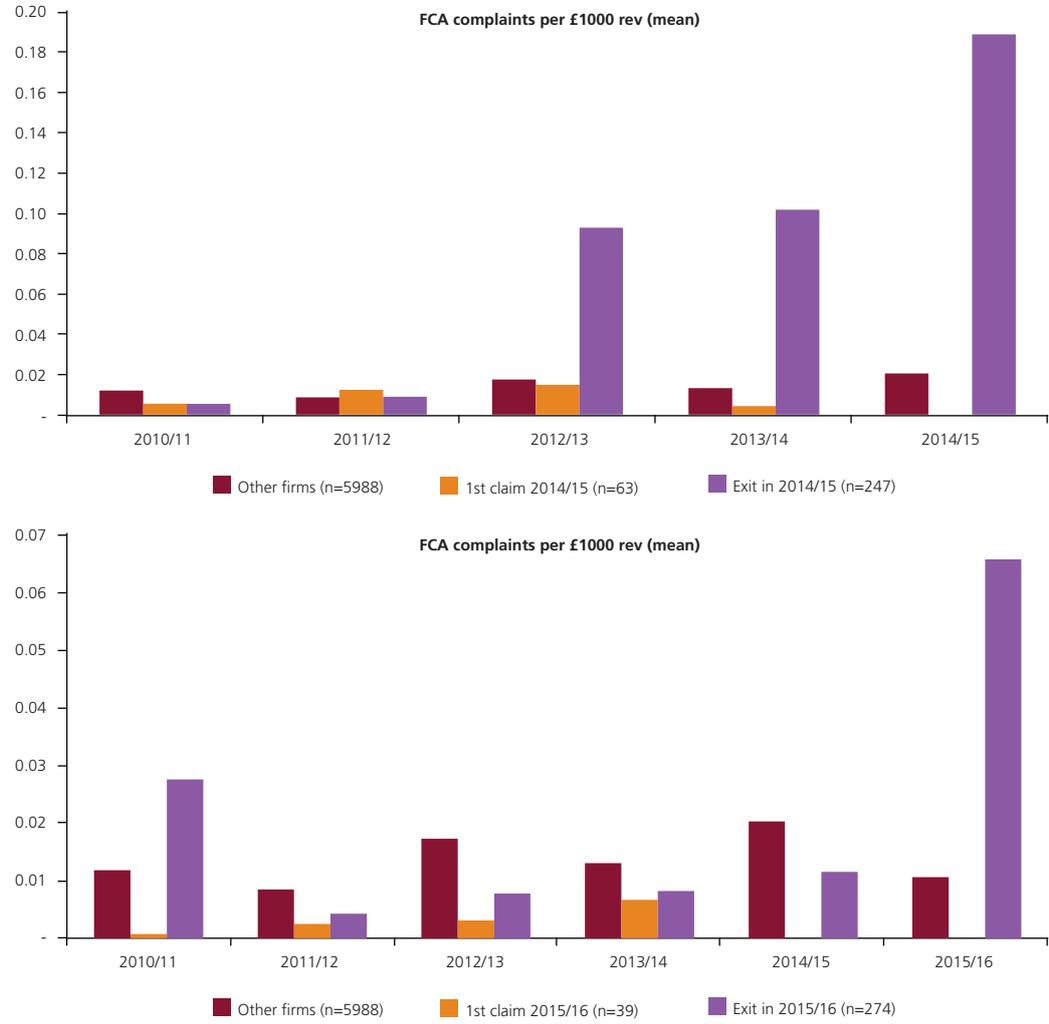
**Figure 5: Median RoA**



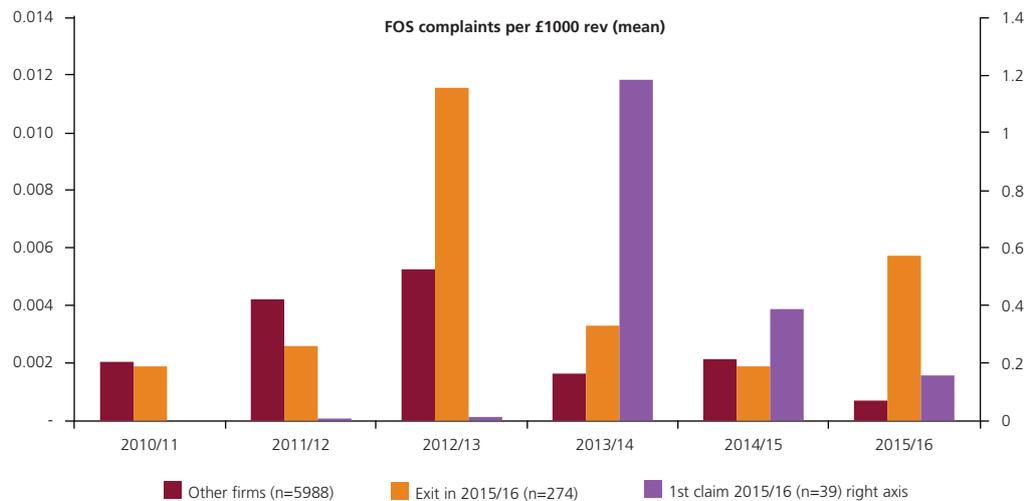
**Analysis of FCA and FOS complaints**

25. FCA complaints data suggest that firms that exit the market incur a higher than average number of complaints. Nevertheless, this is not the case for firms that generate FSCS claims, which may be due to the small sample size. Apart from small sample of firms associated with FSCS claims, only a subset of those firms report FCA complaints. Out of the about 17,000 firms in 2015/16, only 6,072 report both FCA complaints and revenue data. Out of these 6,072 firms, 4,493 report at least one FOS complaint. Many firms (almost a half each year) report no complaints for FCA, and even fewer report FOS complaints. When FOS complaints do occur, it is likely that there are also FCA complaints for that firm.

**Figure 6: Average number of FCA complaints per £1000**



**Figure 7: Average number of FOS complaints per £1000 revenue (note right axis on some series)**



- 26. FOS complaints give a more conclusive picture, although the results are driven by fewer instances of firms with FOS complaints. Out of 17,000 firms in the sample for 2015/16, only 6,072 report both FOS complaints and revenue data. Out of these 6,072 firms, 3,325 report at least one FOS complaint.
- 27. We have not been able to complete similar analysis for Investment Providers (in the graphs above) because there has been such a low number of claims over the past 5 years in this class. The above graphs rely on the distinction between firms that survive, exit and generate FSCS claims.

## Findings

### Econometric analysis

28. The survival analysis<sup>114</sup> tests whether the six measures have any predictive power in terms of predicting firm exits from FSCS-related markets. Specifically, this econometric method is a tool to estimate how much more likely a firm is to exit in relative terms when one of the metrics changes. Its advantage is that we can estimate how an increase or decrease in a risk metric changes the probability of a firm exiting. For instance, given the estimates discussed below, a 100% increase in liquidity ratio is associated with a 21% lower relative probability<sup>115</sup> of a firm exiting in the subsequent year.
29. As a robustness test, we check the results of the survival analysis with two other models: the so-called stacked logit and stacked probit models.<sup>116</sup> The findings are similar among the three models, which implies that results are not very sensitive to the model selection.<sup>117</sup> The full findings of this analysis are available on request.

### Linear relationship between risk metrics and firm exit occurring

30. Before undertaking the econometric estimation, a simple correlation analysis shows that there is no linear relationship (correlation) between firms that exit any of the six metrics. This has two implications:
- If there is any link between firm exit and the risk metrics, it is non-linear. This means that it is not a simple relationship where the probability of exit increases by x% when a given risk metric, eg FOS complaints, increases by y number of complaints. This lends support to analysing the data with non-linear models such as survival analysis.
  - It also allows us to understand whether there is any interaction between the six risk metrics themselves. We found a degree of interaction between complaints about these firms to the FOS and FCA. This means that it may be difficult to distinguish between FCA and FOS complaints for any potential impact on firm exit, as the two move in tandem.

### Link between firm exit and FSCS claims

31. The data show that among intermediation firms that exit, about one in ten also generates an FSCS claim. Nevertheless, the proportion of firms generating FSCS claims is only 2% for intermediaries in the data for which we observe FSCS claims. This means that the econometric analysis on the risk of firm exit only relates to risk of FSCS claims indirectly. Identifying which firms are more prone to exit may indirectly identify which firms are more prone to generate FSCS claims. However, this indirect identification would hold for only 1 in approximately 10 identified firms.
32. The following two tables set out the split in the data sample by the three groups of firms studied in this document.

114 Survival because it deals with survival of subjects over time, in this case we can think of 'survival' as firms continuously operating from one year to the next.

115 By this we mean that if for instance a firm's expected exit in a given year is 1 in 10, ie 10%, doubling of its liquidity ratio would decrease this by a factor of 0.79, so its expected exit would decrease to 8% or about 1 in 12.

116 These two econometric techniques are sometimes called pooled logit and pooled probit.

117 The survival analysis is used as it is considered more efficient. The survival analysis model takes into account the time dimension. In contrast, logit and probit treat each observation as independent instead of recognising that each firm is observed over time. This means that while the estimated coefficients themselves are similar across the three models, the survival analysis gives more accurate confidence interval boundaries.

**Table 1: Intermediation firms – split by exit and by FSCS claims**

<b>Intermediaries 2010/11 to 2016/16</b>	<b>No FSCS claim</b>	<b>FSCS claim</b>	<b>Total</b>
<b>Live</b>	12,434 (80%)	0	12,434 (80%)
<b>Exit</b>	2,842 (18%)	293 (2%)	3,135 (20%)
<b>Total</b>	15,276 (98%)	293 (2%)	15,569 (100%)

33. Among the investment providers, there are no FSCS claims in our sample. The exit rate at 15% is similar to the exit rate of 18% of the intermediaries.

**Table 2: Investment providers – split by exit (there are no FSCS claims)**

<b>Investment providers 2010/11 to 2016/16</b>	
<b>Live</b>	490 (85%)
<b>Exit</b>	87 (15%)
<b>Total</b>	577 (100%)

34. As mentioned above, ideally, with a larger and longer dataset we could perform the econometric analysis on the risk of FSCS claims rather than market exits. The relatively low number of firms that generate an FSCS claims means that we cannot obtain meaningful estimates with this model if FSCS claims were used as the outcome that we are trying to predict.<sup>118</sup>

#### **Econometric analysis of the intermediaries**

35. The results from the analysis of intermediation firms suggest that out of the six risk-based measures, three have a meaningful predictive power of firms' exit:<sup>119</sup> liquidity ratio, and both FCA and FOS complaints. A 100% increase in liquidity ratio is associated with a 21% lower relative probability of exit in a given year. For the same increase in FCA complaints or in FOS complaints, relative probability of exit increases by 10% and 4% respectively.<sup>120</sup> It should be noted that a rise in the number of FOS and FCA complaints (adjusted per £1000 of firm's revenue) typically occur simultaneously. Monitoring one type of complaints could thus capture the risk associated in both. If for instance, FCA may believe that the FCA complaints reporting would be affected by a change in policy, it could choose to monitor FOS complaints instead.
36. It should be noted that these findings may be sensitive to other drivers that are not in the data. If we have reasons to believe that any of the six measures are in turn driven by other underlying characteristics (such as the type of products the firm sells), then we should directly associate risk with those underlying drivers. As current data do not allow for a further breakdown, this note does not attempt to explain in more detail what may drive changes in the chosen six metrics.

<sup>118</sup> In technical terms, we say that there are not enough degrees of freedom for the estimation.

<sup>119</sup> Statistical significance at 1% confidence level.

<sup>120</sup> By this we mean that if, for instance, a firm's expected exit in a given year is 1 in 5 (ie, 20%) doubling the number of FCA complaints would lead us to expect its exit rate to increase to about 1 in 5.5, ie about 22% (20% times a factor of 1.1).

**Table 3: Summary findings of the survival analysis – the full findings of this analysis are available on request**

<b>Risk metric</b>	<b>Impact on probability of exit associated with risk metric increasing by 100%</b>	<b>Comments</b>
<b>Leverage ratio</b>	0%	Not statistically significant.
<b>Liquidity ratio</b>	-21%	A relative decrease by 21%.
<b>Return on assets</b>	0%	Not statistically significant.
<b>Capital ratio</b>	<1%	
<b>FCA complaints</b>	10%-14%	Complaints are statistically significant, however, it is difficult to separate the impact between the two variables.
<b>FOS complaints</b>		

**Econometric analysis of investment providers**

- 37.** Among investment providers, the analysis only recognises the liquidity ratio as being a significant predictor of a firm exit. A 100% increase in the liquidity ratio is associated with a 68% lower relative probability of exit in a given year. By this we mean that if, for instance, a firm's expected exit in a given year is 1 in 6 (ie 17%) then increasing its liquidity ratio by 1 would lead us to expect its exit rate to decrease to approximately 1 in 18, ie 5.3% (17% times a factor of 0.32).
- 38.** As discussed above, there have been very few FSCS claims in the investment provision class since 2011/12. As a result, we are unable to generate comparable graphs as we do in the section above on the intermediaries.

**Conclusion**

- 39.** This document considers four risk metrics as well as FCA and FOS complaints for predicting firm exits and FSCS claims. Three of the measures have some degree of predictive power for a firm exit:
- a 100% increase in a firm's liquidity ratio is associated with 21% relative decrease of its probability to exit in the given year
  - firms with double the FCA complaints compared to its peers are 10% more likely to exit in a given year, and
  - similarly, this factor is 4% if FOS complaints are doubled
- 40.** The leverage ratio and RoA do not have any statistically significant predictive power for a firm exit. Capital only shows a minor impact on probability of exit. This may be because many exiting firms are stable and choose not to operate in this space, in contrast to firms that generate FSCS claims that decrease capital in their final years (see Figure 1).
- 41.** We will need to explore further whether these measures are suitable for setting FSCS levies. This includes exploring the impact of a levy design that utilises these measures on firm behaviour. This could, for example be positive behaviour (e.g. averting future risk) or negative behaviour (e.g. hastening the exit of declining firms or encouraging others to game the system). We

will be exploring these questions as we consider the development of the proposals set out in Chapter 4.

## Appendix A: FSCS and RMAR data merging details for intermediaries

**Table 4: Intermediaries – details of merging FSCS claims data with RMAR data**

Claim	No claims	Claims, merged	Claims, not merged
Total amount of claims	–	£1,115m	£160m
Number of firms	22,012	694	2,292
Average claim	–	£1,607,237	£69,772
Median claim	–	£54,162	£5,720
Capital (avg)	£21,417,905	£358,768	–
Surplus (avg)	£503,073	£113,552	–
Number of ARs (avg)	89	10	–
Number of ARs giving advice (avg)	5	2	–

**Table 5: Intermediaries – details of merging FSCS eligible income data with RMAR data**

FSCS Class	Merged with RMAR		Not merged with RMAR		% firm-years merged	% eligible income merged
	Number of firm-years	Average eligible income	Number of firm-years	Average eligible income		
GI Intermediation	36,194	£992,089	3,888	£2,229,812	90%	81%
L&P Intermediation	25,909	£396,273	3,999	£1,462,633	87%	64%
Investment Intermediation	22,124	£200,096	5,441	£2,502,020	80%	25%
Investment Provision	60	£1,089,614	2,546	£6,944,440	2%	0%
Home Finance Intermediation	17,045	£150,941	2,220	£1,200,947	88%	49%

Note: We carried out investment provision analysis on merged FSCS and FSA datasets. The information of Investment provision here is provided for reference only.

# Annex 4

## Analysis of affordability

### Summary and headline results

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1. We have conducted an affordability analysis to support the development of the FSCS class structure proposals and to develop a broad understanding of the burden of FSCS levies on firms. It uses data from the past five years to estimate the effect of the proposed thresholds on firm profitability and likelihood of exiting the market for the intermediation and investment provision classes. In all cases, the analysis considers the impact of the maximum potential contribution under each option (e.g. assuming all intermediation class thresholds are reached simultaneously), and considers intermediation and investment provision independently. It does not consider the distribution of impacts among different types of firms or the likelihood of the thresholds being reached under each option. The results are compared to a situation where there is no FSCS levy.
2. The approach calculates the levies that firms would have paid had the merged intermediation and investment provision thresholds been reached. It also counts the firms for whom the levy would have exceeded gross operating profit averaged over three years. To estimate potential firm exit, we compare the fraction of lossmaking and profitable firms over the three years to 2013/14 that subsequently exited the market at any point in the next two years. We then use the difference to estimate how many of the firms that would have been pushed into loss by their FSCS levy would potentially go on to exit the market in the subsequent two years. Our estimate of the additional likelihood of exiting as a result of making a loss is relatively small.
3. The analysis is designed to test the impacts of a severe scenario, rather than the most likely outcome. The estimates capture the impact of the proposed thresholds being reached in three consecutive years.<sup>121</sup> To put this in context, funding requirements over the past five years for intermediation classes as a whole have averaged 26% of the £590 million threshold, and have not exceeded 33% in any one year. The headline results also assume that firms are not able to pass on costs to consumers whereas, in reality, firms do pass on at least some of these costs. Passing costs on to consumers would reduce the estimated impacts considerably. The results are not strictly a worst-case scenario, for example, the conditions under which the threshold would be reached could result in other unpredictable implications for firm exit. However, the results represent a strong overestimate of any likely outcome.
4. Even under the severe assumptions, we estimate that the proposed thresholds would have a relatively small impact on firm profitability and market exit. Table 1 provides the headline results. Had the intermediation thresholds been reached simultaneously in the three years to 2015/16, then about 650 intermediaries (6% of the total) would have been pushed into average loss by their FSCS levy, of which about 50 (0.4% of the total) would have exited the market. The estimated impacts are very similar for the three options. This suggests the affordability

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<sup>121</sup> We use average profit minus the levy, which is equivalent to total three-year profit minus three consecutive levies at the threshold.

implications are not materially different (though the likelihood of the threshold being reached would differ).

5. For investment providers, if the £200m threshold had been reached (the same in all three options), then about 75 firms (13% of investment providers) would have been pushed into loss by their FSCS levy. Of these, fewer than ten (1%) would have exited the market. It should be stressed that comparing the impact of the levy compared with no FSCS levy will always result in some firms being estimated to lose out.

**Table 1: Headline estimates of the impact of the intermediation and investment provision thresholds being reached compared to no FSCS levy (three-year averages):**

*Option 1 – Merged intermediation class (threshold £590m) with provider contributions*

	<b>Year (3 years to...)</b>	<b>Estimated number and percentage of firms pushed into loss</b>	<b>Number and percentage of firms estimated to exit the market in subsequent 2 years</b>
<b>Intermediaries</b>	2015/16	655 (6.0%)	48 (0.4%)
	2014/15	666 (6.1%)	48 (0.4%)
	2013/14	803 (7.6%)	58 (0.6%)
<b>Investment Providers</b>	2015/16	74 (12.6%)	6 (1.0%)
	2014/15	54 (9.0%)	4 (0.7%)
	2013/14	113 (18.5%)	9 (1.5%)

*Option 2 – Merging investment intermediation and life & pensions intermediation, with provider contributions*

	<b>Year (3 years to...)</b>	<b>Estimated number and percentage of firms pushed into loss</b>	<b>Number and percentage of firms estimated to exit the market in subsequent 2 years</b>
<b>Intermediaries</b>	2015/16	647 (5.9%)	47 (0.4%)
	2014/15	688 (6.3%)	50 (0.5%)
	2013/14	841 (8.0%)	61 (0.6%)
<b>Investment Providers</b>	2015/16	74 (12.6%)	6 (1.0%)
	2014/15	54 (9.0%)	4 (0.7%)
	2013/14	113 (18.5%)	9 (1.5%)

*Option 3 – Current structure with provider contributions (threshold £590m)*

	<b>Year (3 years to...)</b>	<b>Estimated number and percentage of firms pushed into loss</b>	<b>Number and percentage of firms estimated to exit the market in subsequent 2 years</b>
<b>Intermediaries</b>	2015/16	652 (6.0%)	47 (0.4%)
	2014/15	667 (6.1%)	48 (0.4%)
	2013/14	790 (7.5%)	57 (0.5%)
<b>Investment Providers</b>	2015/16	74 (12.6%)	6 (1.0%)
	2014/15	54 (9.0%)	4 (0.7%)
	2013/14	113 (18.5%)	9 (1.5%)

6. A more intuitive way of understanding the affordability implications of the merged class is to compare the proposed thresholds with the current class structure. The number and fraction of firms that we estimate would make a loss and exit the market under the current class structure is identical to Option 3 above. The results are very similar to the Options 1 and 2, suggesting that the proposed class structures do not create additional affordability problems where the thresholds are reached. This does not imply that the class structures would have no effect. The proposed options would affect different types of firms in different ways (even if the aggregate impact is similar), and the likelihood of the thresholds being reached will clearly be different, for example, because of the impact of provider contributions.
7. As with any estimation, the results need to be used carefully. The estimates are based on a number of assumptions and there are caveats to their use.
8. There are several reasons why our estimates could overestimate the impact of the relevant extreme scenario. Firstly, a firm's profitability can understate affordability. A high degree of costs passed through to consumers, scope for efficiencies which would increase profitability, and the potential difference between economic and accounting profits means that true profitability could be higher than reported. More generally, firms faced with unexpectedly high FSCS levies may be expected to respond strongly (passing on costs or economising within the firm). These kinds of responses are hard to capture in a retrospective static analysis and could lead to us overestimating the number of firms that will make a loss and exit the market.
9. Other methodological issues could underestimate the impacts of the relevant scenario on lossmaking and firm exit. For example, if the thresholds were reached, assumptions taken from the past six years might not be valid. For example, if the threshold was triggered because of negative macroeconomic conditions, those conditions also could have wider implications for firms that are difficult for us to assess and predict. Secondly, we do not look at the effects of a levy pushing firms into low positive profits or from loss into deeper loss. This could mean we underestimate the number of firm exits, though it is hard to verify.
10. Finally, there are some issues that add to the uncertainty of the results. Firstly, we can only estimate the profit that firms make on FSCS-protected intermediation or investment provision. We take firm-wide profit and allocate it to these activities on a pro-rata basis according to income. This might not reflect reality for various reasons, for example, if there is cross-subsidisation. However, similar results using firm-wide profits – that is, not scaled down for the fact that FSCS revenues are a part of wider RMAR-recorded revenues – are largely similar.

Secondly, FSCS and RMAR data do not always correspond. This is partly due to different reporting years but there may be other reasons. Any errors recorded in the data that we were unable to detect would affect our estimates of class-specific profit. Thirdly, we refer to ‘firm exit’ rather than ‘firm failure’ as we cannot distinguish between the two in the data. Fourthly, the datasets that are missing average profit show a number of findings. We apply our results over the total number of firms, which assumes that observations with valid profit represent these firms as a whole.

11. Please note that the results cannot be directly compared to the Deloitte affordability analysis in 2009,<sup>122</sup> though we have drawn from the methodology. For instance, we use three-year average affordability and activity-specific profits as opposed to a single year in the 2009 study. Our view is that trying to estimate how likely firms are to pass through costs to consumers is too uncertain to justify detailed analysis, although we have tested this in preliminary work.

## Data

### Population of firms used

12. Our analysis uses firm-level data from FSCS combined with data from the FCA RMAR for intermediation firms and FSA data for investment provision firms over the period 2011/12 to 2015/16 (five years).
13. FSCS data cover all firms in the FSCS retail pool and contains eligible income for each current FSCS class. RMAR and FSA data contain profit and revenue data for entire firms,<sup>123</sup> of which only a subset may be FSCS-relevant activity. RMAR and FSA profit and revenue is not broken down by FSCS-related activity or class. The datasets are merged at the firm level using FRN identification numbers and years.
14. Table 2 shows the number of firms with non-zero FSCS-eligible income in the proposed merged intermediation class and the investment provision class. There are around 11,000 intermediaries and 600 investment providers (data are missing for the lower totals in 2011/12). These groups are not mutually exclusive – around half of investment providers are also active in intermediation. There is considerable churn within these totals – in total there are 15,484 unique observations of firms that report positive FSCS-eligible income in at least one year.

**Table 2: Number of active firms in intermediation and investment provision**

Year	Intermediation	Investment provision
2011/12	9,355	184
2012/13	11,485	628
2013/14	10,544	610
2014/15	10,882	599
2015/16	10,938	585

### Missing profit

15. A substantial proportion of observations have missing profit data. Our preferred profit measure for intermediaries is gross operating profit from RMAR, which is missing for around 14% of

<sup>122</sup> Deloitte, *Assessing the affordability and thresholds of FSCS levies* (March 2012) [www.fsa.gov.uk/pubs/other/deloitte-29mar12.pdf](http://www.fsa.gov.uk/pubs/other/deloitte-29mar12.pdf)

<sup>123</sup> RMAR data refer to regulated activities only, ie. only financial services.

observations. However, using average profitability means that firms without three consecutive years of observable profit, such as recent entrants to the market, are also excluded. Therefore the proportion of intermediaries with missing average profit in the usable data is substantially higher than 14%; Table 3 summarises the proportion of valid/non-missing observations available. Between 27% and 43% of observations of intermediation firms are missing average profit data. Using average profitability restricts the analysis to the period 2013/14 to 2015/16.

**Table 3: Missing and valid observations – intermediation class**

	<b>A</b>	<b>B</b>	<b>C</b>
<b>Year</b>	<b>Total firms with positive eligible income</b>	<b>Valid 3-year average profit</b>	<b>Percentage with valid profit (B as a % of A)</b>
2011/12	9,355	–	–
2012/13	11,485	–	–
2013/14	10,544	6,031	57%
2014/15	10,882	7,748	71%
2015/16	10,938	7,931	73%

16. For investment providers, a larger fraction of observations have missing profit data. The profit measure for the investment provision class is also gross operating profit from FSA data, which is missing for approximately 26% of observations. For investment providers, average profitability is missing for between 78% (three years to 2013/14) and 39% (three years to 2015/16) of firms.
17. There are some differences between the characteristics of missing and valid observations. We produced the results in this analysis by estimating the fraction of firms affected by the levies using the data available, and applying these results to all firms.
18. We have therefore compared the distribution of intermediation and investment provision income between observations with missing and valid average profit – an indicator of whether the valid observations are representative of the population. There is some evidence to suggest that observations with missing average profit data have, on average, lower intermediation income than those with valid average profit, especially for 2013/14. Similarly, recent entrant firms (for which we have profit data but are not included) appear to be slightly less profitable than those for which we have three consecutive years' profit.
19. Overall, the missing observations are therefore likely to have lower income than the firms used in the analysis, and may possibly be less profitable. This is not accounted for when we apply the results to all firms, so our approach may underestimate negative impacts on firms caused by the FSCS levy.<sup>124</sup>

#### **Discrepancies**

20. The merged FSCS-RMAR and FSCS-FSA datasets contain some discrepancies between revenue and eligible income. In around a quarter of cases, FSCS eligible income is reported to be larger than RMAR or FSA revenue for the entire firm, that is, a subset of a firm's revenue is reported to be larger than the same firm's total revenue. This may be due to a different reporting period for FSCS and RMAR or FSA data, or other unknown data reporting errors. We have aligned

<sup>124</sup> We observe that firms with lower income are more likely to exit the market. Since missing observations have lower income, this would normally mean that our estimates of firm exit could be underestimated.

the annual RMAR and FSA data as far as possible with the FSCS financial year that runs from April through March. In some cases this was not possible due to different periods of reported RMAR or FSA data that are on a different annual or different quarterly time frame. The section on class-specific profits below describes our approach for estimating class-specific profit where FSCS-reported income is greater than RMAR/FSA-reported revenue.

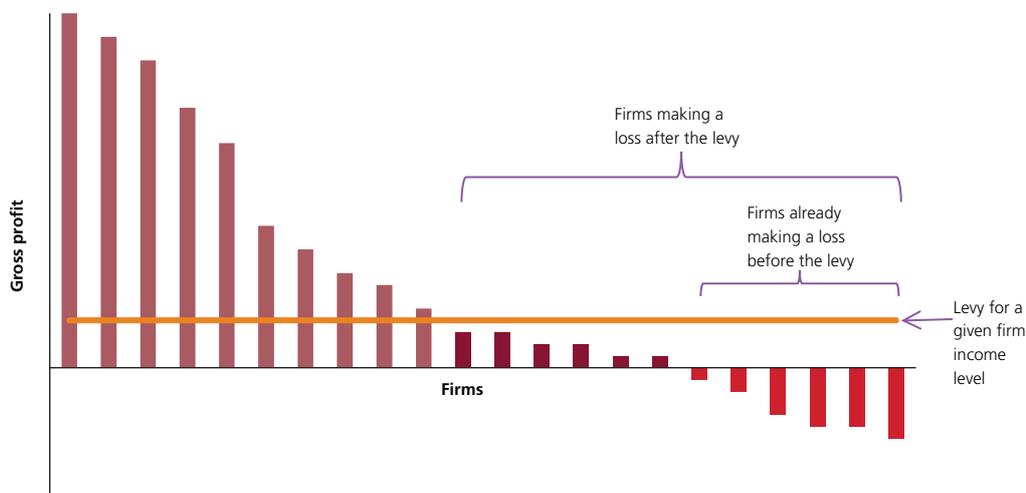
**Exits**

- 21. The analysis uses data from the past five years to count firms that have observable average profit over the period 2011/12 – 2013/14 and subsequently exited the market in either 2014/15 or 2015/16. We consider a firm to have exited if we observe both its total assets and income (FSCS eligible income) to be zero. Some firms appear to only be dormant in one of the years in our data but become operative (their revenue or capital turns positive) in a subsequent year. These are considered to be live firms. Note that firms labelled as having exited may still be active and solvent in other markets, but they no longer undertake FSCS-related activities (the indicator captures voluntary exit as well as firm failure).

**Summary of our approach**

- 22. The affordability analysis models the way proposed changes to the structure and level of FSCS funding requirements would have affected firms on the basis of the past five years. In all cases, the analysis considers the impact of the maximum potential contribution under each option, for example, assuming all intermediation class thresholds are reached simultaneously. We calculated individual firm levies under these proposed thresholds using each firm’s share of the total income in that class in that year. We model the impact of the intermediation and investment provision thresholds independently.
- 23. The approach estimates the number of firms that would have been pushed into negative gross profit by their FSCS levy, assuming no other dynamic changes. The results compare the number of firms that made an average loss in the absence of FSCS levies with the number of firms that would have made an average loss had the proposed thresholds been reached (Figure 1).

**Figure 1: Identifying firms affected by the FSCS levy at the threshold (illustration for firms with the same income)**



**Profit variable**

24. Since profits will depend on annual variation, our preferred profitability measure is three-year average gross profit. Using average profitability helps remove the effect of volatile profits across years on the results and provides a more accurate picture of the effect of the FSCS levy. The results also implicitly reflect the impact of the funding thresholds being reached in three consecutive years.<sup>125</sup>
25. Since the counterfactual is taken to be no FSCS levy, we add the fee that firms actually paid in each year to their observed gross profit.

**Class-specific profits**

26. We estimate the profit that firms earn from their FSCS-regulated activities, as opposed to using firm-wide profit that may reflect wider influences. To estimate the profits that firms earn from their intermediation or investment provision activities, we allocate firm-wide RMAR gross profit on a pro-rata basis according to income. We assume that gross profit is directly proportional to a firm's revenue. So we divide FSCS intermediation revenue or FSCS investment provision revenue by total firm revenue and multiply by gross profit.
27. If a firm's FSCS-protected revenue is reported to be larger than the same firm's total revenue in RMAR, we adjust the approach above. In these cases, we restrict the ratio of FSCS revenue to firm revenue to a maximum of one, meaning that estimated gross profit from intermediation and investment provision combined never exceeds observed RMAR/FSA firm-wide profit. Importantly, while we can correct for cases where FSCS income exceeds total revenue, there may be other data inconsistencies that are not detected because of the different reporting years.<sup>126</sup>
28. Estimated class-specific profit may be inaccurate for a number of reasons. Firms may cross-subsidise different products, so undermining the pro-rata assumption. Different FSCS classes may be substantially more profitable than others (including the existing intermediation classes) or may have different cost structures.
29. Using firm-wide profits raises separate issues. Chiefly it is not possible to identify firms that make a loss from FSCS-protected activities but remain in overall profit. However, since firm-wide profits are observable and require no assumptions, they provide a useful sense check of our preferred analysis. Preliminary analysis using firm-wide profit as the profitability variable resulted in broadly similar estimates.

**Missing observations**

30. To address the issue of missing observations, we scale up the results for each year accordingly. We take the estimated proportion of firms that would be pushed into an average loss as a result of their FSCS levy and multiply this by the total number of firms active in that class in that year. In effect, this is an assumption that firms with missing profit data are similar to other firms.

**Dynamic effects and cost pass-through**

31. The headline results do not take into account dynamic reactions that firms would take in response to levies at the threshold level. They focus purely on how levies would have affected profitability if all other factors were constant. In reality, firms would react in various ways, most obviously in trying to pass costs on to consumers, restructuring their own costs, such as pay and bonuses, or business model. One of the key drivers of levy affordability for firms would

<sup>125</sup> We use average profit minus the levy, which is equivalent to total three-year profit minus three consecutive levies at the threshold.

<sup>126</sup> If the different reporting years between FSCS and RMAR/FSA data cause a wider inconsistency in our measure of the income as a share of revenue, then we would not be able to detect a problem where reported FSCS-regulated income is less than reported total revenue, even if the ratio was for some reason incorrect for the year in question.

likely be the ability to pass costs on to consumers, which would depend, among other things, on profitability, changes in demand and supply, the prevalence of long-term contracts and competitive conditions.

32. Estimating how much firms are likely to pass on costs to consumers involves large amounts of uncertainty. Deloitte's 2009 report estimated this cost pass-through taking into account: 'the effect of market structure and degree of competition; the effect of relatively price elasticity of demand and supply; and further considerations, including levy structure and cross-subsidisation within financial conglomerates operating across multiple sub-classes'. The estimated degree of cost pass-through ranged between 0% for building societies to 80% to 95% for GI intermediation. Given the uncertainty involved, particularly what the various components of pass-through would look like in a scenario where thresholds were being reached, we felt it was not worthwhile to replicate this analysis.
33. Our preliminary analysis modelled scenarios of the number of firms that would make a loss and exit the market if all firms passed on 50% or 75% of their levy costs to consumers under Option 1. High degrees of cost pass-through would sharply reduce the estimated number of firms that would make a loss due to their FSCS levy. By not taking into account this possibility, the headline estimates should be interpreted as an overestimate of the scenario.

#### **Lossmaking and exit**

34. Not all firms that make a loss will exit the market. To estimate the impact of the proposed FSCS thresholds being reached on firm exit, we look at past data to estimate the additional impact that making an operating loss has on leaving the market.
35. We look at firms that made an average loss or an average profit in the three years to 2013/14. We compare the proportion of lossmaking firms that exited the market in the subsequent two years (2014/15 or 2015/16) with the proportion of profitable firms that exited the market in the same period. So the results regarding exit are only an estimate of exit within the subsequent two years (the fraction would be higher if we examined a longer period).
36. More firms that made a three-year average loss in the previous three years exited the market in 2014/15 – 2015/16 than firms that made an average profit. Table 4 compares the proportion of lossmaking and profitable firms that exited the market in our dataset, using estimated intermediation and investment provision profit. For example, for every 100 intermediation firms that were, on average, profitable, Table 3 implies that 7 exited the market in the latest two years. Whereas for every 100 intermediaries that made a loss on average, 14 exited the market. The difference between these two gives the estimated additional impact that making a loss has on the likelihood of a firm exiting the market. The relatively small difference between the two proportions is a large driver of why we would estimate relatively few firms would exit the market if the proposed thresholds were reached.

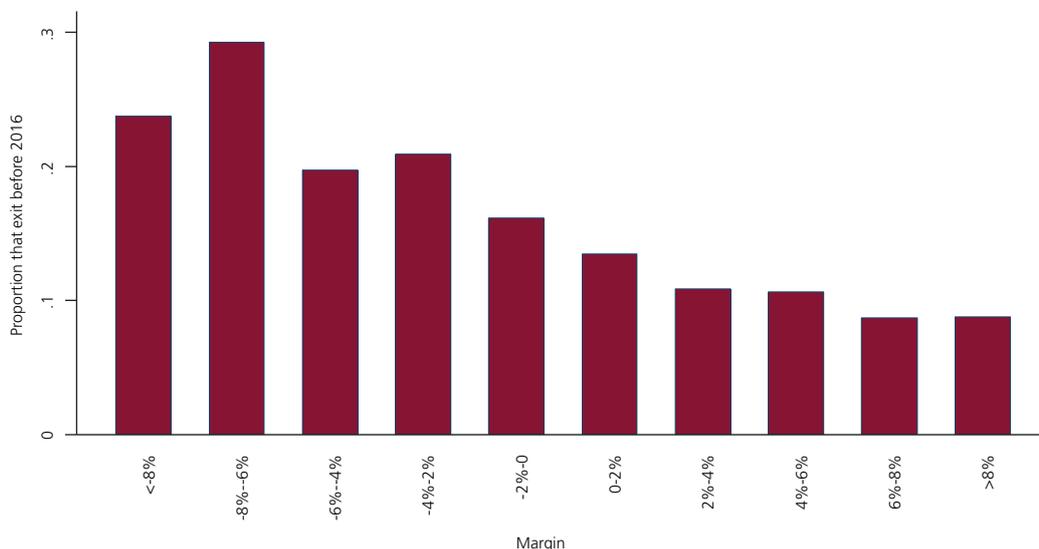
**Table 4: Estimated impact of average profitability (all years) on firm exit**

		<b>Exited before 2016</b>	<b>Did not exit</b>
<b>Intermediation</b>	Firms making a profit	7%	93%
	Firms making a loss	14%	86%
	<b>Difference</b>	<b>7%</b>	
<b>Investment provision</b>	Firms making a profit	9%	91%
	Firms making a loss	18%	82%
	<b>Difference</b>	<b>10%</b>	

37. An estimate for firm exits can be derived from (i) the number of firms where the FSCS levy would have exceeded average profit, and (ii) the difference in firm exit rates from Table 4. Multiplying (i) by (ii) gives an estimate of the number of firm exits expected from the proposed thresholds being reached. Again though, it is important to note that this is a static analysis and does not take into account cost pass-through or other dynamic firm adjustments.
38. These estimates of firms exiting are only indicative. Firstly, the distinction between profit and loss does not capture all of the impacts on firms. A firm may remain profitable after the levy, but at a rate of return below the cost of capital or the opportunity cost of an owner's time. Similarly, firms already in loss may be pushed deeper into loss, increasing the likelihood of them exiting. Secondly, a scenario in which the thresholds were reached would probably show a very different macroeconomic situation from that of the past five years. For instance, if the threshold was triggered due to adverse macroeconomic conditions, those same conditions could simultaneously increase the chance of lossmaking resulting in exit (for example, if borrowing was more expensive or restrictive). Thirdly, the distinction between firms exiting or remaining may be too blunt in reality – firms may react and focus on the area with the highest margin.<sup>127</sup> The reaction of small owner-managed firms, where profitability is linked with salary owners who pay themselves and can be hard to interpret, may partly depend on behavioural reactions by owners. Finally, a delay between a period of average loss and exit would not be captured by our measure of exit.
39. In response to the issue that the scale of profit or loss is important for exit, Figure 2 provides some analysis of exit rates by profit margin. There does not appear to be a clear relationship between profit margin and the likelihood of a firm exiting (note the figure is based on firm-wide profits whereas the main results are based on estimated intermediation and investment provision profits). Firms making a low positive profit margin have a higher probability of exiting than firms with larger margins, as would make intuitive sense. But above a profit margin of around 6% there does not seem to be any relationship between margin and exit. For lossmaking firms, the magnitude of loss does not seem to be closely related to probability of exit – firms with a large negative profit margin are less likely to exit the market than those with a small negative margin. This implies that the approach used in our paper of predicting firm exit on the basis of firm profit versus firm loss may be a reasonable approximation.

<sup>127</sup> There is no evidence that firms whose past FSCS levies pushed them from profit into loss were any more likely to exit the market than other lossmaking firms.

**Figure 2: Exit rate of firms and average firm-wide profit margin (all years combined)**



**Previous approaches**

- 40. We have drawn on previous analysis of the affordability of FSCS levies by Oxera in 2006<sup>128</sup> and Deloitte in 2009.<sup>129</sup> Oxera calculated the size of thresholds by taking a fixed percentage of estimated eligible income for each FSCS class. The report compared these thresholds to affordability benchmarks such as previous contribution limits. Despite listing high-level profit margins for different types of firm, Oxera did not directly model the impact of levies on firm profitability. Deloitte’s approach produced indicators of firms’ profitability and then calculated a weighted average of each indicator as a measure of affordability for a notional average firm in the class. They then developed a number of scenarios that reflected the potential for macroeconomic and regulatory changes to affect profitability. The scenarios also involved different levels of cost pass-through of FSCS fees, depending on estimates of firms’ market power and high-level assessments of changes to demand and supply for each class. These scenarios then determined a range of candidate thresholds for each class. The Deloitte study estimated affordability based on a single year of data, 2009.
- 41. Our approach clearly differs from previous analysis in several ways and therefore the results should not be directly compared. The main differences are the use of average profitability over three years, using five years’ worth of data instead of one, the use of estimated class-specific profit and the absence of any cost pass-through assumptions. By using average profitability and several years of data we should provide a more representative picture of affordability. Using class-specific profit allows the possibility that firms would exit FSCS activities despite making a profit at the firm-wide level.

128 Oxera, *Funding the Financial Services Compensation Scheme Analysis of policy options*, Prepared for Financial Services Authority (March 2007) [www.oxera.com/Oxera/media/Oxera/FSA-funding-the-Financial-Services-Compensation-Scheme.pdf?ext=.pdf](http://www.oxera.com/Oxera/media/Oxera/FSA-funding-the-Financial-Services-Compensation-Scheme.pdf?ext=.pdf)

129 Deloitte, *Assessing the affordability and thresholds of FSCS levies* (March 2012) [www.fsa.gov.uk/pubs/other/deloitte-29mar12.pdf](http://www.fsa.gov.uk/pubs/other/deloitte-29mar12.pdf)

## Annex 5

# Compatibility Statement

1. This Annex records the FCA's compliance with a number of legal requirements which apply to the proposals in this consultation. This includes an explanation of our 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 FCA is obliged, under section 213(1) of FSMA, to design a compensation scheme under which valid claims are able to be paid. In doing so, the FCA is required by section 213(5) of FSMA to have special regard to the desirability of ensuring that the amount of levies imposed on a particular class of authorised person reflects, so far as practicable, the amount of claims made, or likely to be made, in respect of that class: that is, the desirability of avoiding cross-subsidy.
3. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why we believe making the proposed rules is compatible with its general duties under (a) section 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) section 1B(5)(a) FSMA to have regard to the regulatory principles in section 3B FSMA.
4. This Annex also sets out our 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 (section 1B(4)). This duty applies in so far as promoting competition is compatible with advancing our consumer protection and/or integrity objectives.
5. This Annex includes our assessment of the equality and diversity implications of these proposals.

### Designing a compensation scheme: s.213 of FSMA

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6. The proposed changes to the compensation scheme are designed to ensure that the scheme remains sufficiently funded. The threshold for the new debt management claims class is set at a level which we believe should be adequate to cover the claims in that class. The scheme also has access to the retail pool should claims on that class exceed the class's threshold. We expect that the additional costs from extending scope to intermediation of structured deposits will be minimal. The changes for participants in collective investment schemes will be reflected in increased levies that fund managers and depositaries will pay, in the context of a low likelihood, but high impact, of any claim in that class. The proposal for payments on account is an administrative measure. Both it, and the proposal to allow Lloyd's to be levied an appropriate amount, are aimed to ensure the FSCS has sufficient funding at all times.
7. The proposals have had special regard to the need to avoid cross-subsidy so far as practicable. Under our proposals, the new debt management claims class will be funded by commercial debt

management firms and consumer credit lenders. The contribution of the lenders is essential to make the class sustainable and to ensure that the threshold is at a level we consider adequate to meet likely claims. There is provision for Lloyd's to pay levies under the current funding structure under the PRA's rules. The proposed rule change is to ensure that Lloyd's pays an appropriate level of contribution under the FCA's rules, should there be a call on the retail pool.

### **The FCA's objectives and regulatory principles: Compatibility statement**

8. The proposals in this consultation are primarily intended to advance the FCA's operational objective of securing an appropriate degree of protection for consumers (the consumer protection objective).
9. More specifically, the following are particularly relevant to the proposals relating to debt management, collective investment schemes and structured deposits and the changes to data collection requirements:
  - the differing degrees of risk involved in the areas covered by the proposals
  - the differing degrees of experience and expertise that different consumers have
  - consumer expectations about regulatory protection, and
  - the general principle that consumers should take responsibility for their decisions
10. The proposal for payments on account supports the funding of the compensation scheme as a whole, while the changes to the levies on Lloyd's are for retail pool funding. In broad terms, the proposals help deliver a robust funding model that is sustainable and practical to implement. They will help ensure that sufficient funds are available to pay compensation to eligible consumers and consequently provide ongoing protection for those consumers.
11. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because the availability of compensation will increase consumer confidence when engaging with financial services.
12. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in section 3B FSMA, including in particular the following regulatory principles:
 

***The need to use our resources in the most efficient and economical way***
13. The proposals are formulated in a way that is intended to be the most efficient and economical way of achieving their ends.
14. ***The principle that a burden or restriction should be proportionate to the benefits***  
For the reasons given in the Cost Benefit Analysis, we consider that the burdens imposed by the proposals are proportionate to the benefits, considered in general terms, we expect will be achieved.
15. ***The general principle that consumers should take responsibility for their decisions***  
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.

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

16. 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.

**Expected effect on mutual societies**

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17. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies, although our proposals for the additional data collection for risk based levies will affect firms that distribute mutual society shares.

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

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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.
19. We recognise that the imposition of FSCS levies on the firms affected by the proposed increases in scope for the FSCS may be a barrier to entry, and might perhaps cause some firms to exit the market, although we think this is unlikely. However, we consider that the proposed changes in scope are necessary to advance the consumer protection objective and are in the interests of consumers.
20. For the above reasons, we believe that requiring commercial debt management firms to contribute to levy costs, but not requiring not-for-profits to do so is compatible with competition objectives.
21. Our proposals for additional FSCS cover have regard to the needs of different consumers who use the relevant services, including to the disclosure requirements that enable them to make informed choices.

**Equality and diversity**

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22. 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.
23. The outcome of the assessment in this case is set out in Chapter 1 of this consultation paper.

# Appendix 1

## Draft Handbook text

## FSCS FUNDING AND SCOPE INSTRUMENT 2017

### 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);
    - (f) section 215 (Rights of the scheme in insolvency); and
    - (g) section 316 (Direction by a regulator); 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. Part 1 of Annex C comes into force on [*date of instrument*].
- D. The remainder of this instrument comes into force on 1 April 2018.

### Amendments to the Handbook

- E. The modules of the FCA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2) below:

(1)	(2)
Glossary	Annex A
General Provisions (GEN)	Annex B
Fees manual (FEES)	Annex C
Supervision manual (SUP)	Annex D
Compensation sourcebook (COMP)	Annex E
Consumer Credit sourcebook (CONC)	Annex F

**Citation**

F. This instrument may be cited as the FSCS Funding and Scope Instrument 2017.

By order of the Board  
[*date*]

[*Editor's note:* The text in this Annex takes account of the changes suggested by CP16/18 *Changes to disclosure rules in the FCA Handbook to reflect the direct application of PRIIPS Regulation* (July 2016), CP16/19 *Markets in Financial Instruments Directive II Implementation* (July 2016), and CP16/29 *Markets in Financial Instruments Directive II implementation – Consultation Paper III* (September 2016), as if they were made.]

## Annex A

### Amendments to the Glossary of definitions

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

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

*direct sales of structured deposits*      the sale by a firm with permission for accepting deposits of its own structured deposits.

*intermediation of structured deposits*      (in COMP and FEES 6) any of the following:

- (1)      *direct sales of structured deposits;*
- (2)      in relation to *structured deposits*:
  - (a)      *advising on investments;* or
  - (b)      *dealing in investments as agent;* or
  - (c)      *arranging (bringing about) deals in investments;* or
  - (d)      *making arrangements with a view to transactions in investments;* or
  - (e)      *managing investments.*

*protected debt management business*      *debt management activities* which are covered by the *compensation scheme*, as set out in COMP 5.8.1R.

Amend the following definitions as shown.

*annual eligible*      (in FEES) (in relation to a firm and a class) the annual income (as described in FEES 6 Annex ~~3R~~ 3AR) for the firm's last financial year

<i>income</i>	<p>ended in the year to 31 December preceding the date for submission of the information under <i>FEES</i> 6.5.13R attributable to that <i>class</i>. A <i>firm</i> must calculate <i>annual eligible income</i> from such annual income in one of the following ways:</p> <p>(a) only include such annual income if it is attributable to business <del>conducted with or for the benefit of <i>eligible claimants</i> and is otherwise attributable to compensatable business</del> <u>in respect of which the <i>FSCS</i> may pay compensation</u>; or</p> <p>(b) include all such annual income.</p>
<i>class</i>	<p>...</p> <p>(5) (in <i>FEES</i>) one of the <del>broad classes to which <i>FSCS</i> allocates levies as described set out in <i>FEES</i> 6.4.7AR, <i>FEES</i> 6.5.6AR and <i>FEES</i> 6 Annex 3AR,</del> <u>to which the <i>FSCS</i> allocates levies.</u></p>
<i>client money</i>	<p>...</p> <p>(2B) (in <i>CASS</i> 11 <del>and</del>, <i>CONC</i> 3.9, <i>CONC</i> 8.3, <i>CONC</i> 10, <i>COMP</i> 5 and <i>COMP</i> 12) money which a <i>CASS debt management firm</i> receives or holds on behalf of a <i>client</i> in the course of or in connection with <i>debt management activity</i>.</p> <p>...</p> <p>(4) (in <i>COMP</i> <u>other than <i>COMP</i> 5 and <i>COMP</i> 12</u>) client money for the purposes of the relevant <i>client money rules</i>.</p>
<i>compensation scheme</i>	<p>the Financial Services Compensation Scheme established under section 213 of the <i>Act</i> (The compensation scheme) for compensating <i>persons</i> in cases where <i>authorised persons</i> and <i>appointed representatives</i>, or, where applicable, a <i>successor</i> or a <i>tied agent</i> of a <i>firm</i>, are unable, or are likely to be unable, to satisfy <i>claims</i> against them <u>(and, unless the context otherwise requires, references to the compensation scheme in the <i>FCA's Handbook</i> are to those aspects of the scheme established under the <i>FCA's rules</i>).</u></p>
<i>financial year</i>	<p>(1) (in <i>DISP</i> <del>and</del>, <i>FEES</i> 5 <u>and</u> <i>FEES</i> 6) the 12 months ending with 31 March.</p> <p>...</p>
<i>MiFID investment firm</i>	<p>(1) (in summary) (except in <i>SUP</i> 13, <i>SUP</i> 13A and <i>SUP</i> 14 in relation to notification of <i>passported activity</i>) a <i>firm</i> to which <i>MiFID</i> applies including, for some purposes only, a <i>credit institution</i> and <i>collective portfolio management investment firm</i>.</p> <p>(2) (in full) (except in <i>SUP</i> 13, <i>SUP</i> 13A and <i>SUP</i> 14 in relation to notification of <i>passported activity</i>) a <i>firm</i> which is:</p>

- (a) an *investment firm* with its head office in the *EEA* (or, if it has a registered office, that office);
- (b) a *CRD credit institution* (only when providing an *investment service or activity* or when selling, or advising *clients* in relation to, *structured deposits* in relation to:
- (i) the *rules* implementing the articles referred to in article 1(3) and article 1(4) of *MiFID*);
  - (ii) the requirements imposed upon it by and under *MiFIR*); and
  - (iii) the requirements imposed upon it by *EU regulations* made under *MiFID*); or
- (ba) a *CRD credit institution* (only when providing an *investment service or activity* in relation to *COMP* or *FEES 6*);
- (c) ...
- (3) ...
- participant firm* (1) ~~(except in *FEES 1* and *FEES 6*) a *firm* or a *member* other than:~~
- ~~(a) (in accordance with an *incoming EEA firm* to the extent~~
  - (1) prescribed for the purposes of section 213(10) of the Act (The compensation scheme) and under regulation 2 of the *Electing Participants Regulations* (Persons not to be regarded as relevant persons) an *incoming EEA firm* which is:
    - (i) a *credit institution*;
    - (ii) a *MiFID investment firm*; ~~or~~
    - (iii) [deleted]
    - (iv) both (i) and (ii); ~~or~~
    - (v) an *IMD insurance intermediary* or an *IMD reinsurance intermediary* which is neither (i) or (ii); ~~or~~
    - (vi) an *AIFM* managing an *unauthorised AIF* or providing the services in article 6(4) of *AIFMD*; ~~or~~
    - (vii) an *MCD mortgage credit intermediary*;

in relation to its *passport activities*, unless it has *top-up cover*;

[Note: This covers certain *incoming EEA firms*: see *COMP 14.1* and

## 14.2.1

- (aa) ~~(in accordance with section 213(10) of the *Act* (The compensation scheme) and regulation 2 of the *Electing Participants Regulations* (Persons not to be regarded as relevant persons) an *incoming EEA firm* which is a *management company* other than to the extent that it carries on the following activities from a *branch* in the *United Kingdom* or under the freedom to provide *cross border services*:~~
- (i) ~~*collective portfolio management* for a *UCITS scheme*; or~~
- (ii) ~~*managing investments* (other than of a *collective investment scheme*), *advising on investments* or *safeguarding and administering investments* (the services referred to in article 6(3) of the *UCITS Directive*), but only if it has top up cover; ~~[deleted]~~~~
- (b) a service company;
- (2)
- (c) ~~[deleted]~~
- (d) ~~[deleted]~~
- (e) an *underwriting agent*, or *members' adviser*, in respect of *advising on syndicate participation at Lloyd's* or managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's;
- (3)
- (f) an *authorised professional firm* that is subject to the rules of the Law Society (England and Wales) or the Law Society of Scotland and with respect to its *regulated activities* participates in the relevant society's compensation scheme;
- (4)
- (g) an *ICVC*;
- (5)
- (h) a *UCITS qualifier*;
- (6)
- (i) ~~[deleted]~~
- (j) in respect of the carrying on of *bidding in emissions auctions*, a *firm* that is exempt from *MiFID* under article 2(1)(i);
- (7)
- (k) an *AIFM qualifier*;
- (8)

	(4)	an operator of an electronic system in relation to lending in respect of operating the system.
	(9)	
	(2)	<del>(in FEES 1 and FEES 6) a firm specified in paragraph (1) above that is not a member.</del>
<i>regulatory costs</i>		the periodic fees payable to the <del>appropriate regulator</del> <u>FCA</u> by a <i>participant firm</i> in accordance with <i>FEES 4</i> (Periodic fees).
<i>relevant person</i>		...
	(2)	<u>(other than in COMP)</u> any of the following: ...
<i>top-up cover</i>		cover provided by the <i>compensation scheme</i> for <i>claims</i> against an <i>incoming EEA firm</i> <del>(which is a credit institution, an IMD insurance intermediary, an IMD reinsurance intermediary, a MiFID investment firm, a UCITS management company, an MCD mortgage credit intermediary or an AIFM)</del> in relation to the <i>firm's passported activities</i> and in addition to, or due to the absence of, the cover provided by the <i>firm's Home State compensation scheme</i> <del>(see <u>has elected to participate in accordance with section 214(5) of the Act, regulation 3 of the Electing Participants Regulations (Persons who may elect to participate) and COMP 14 (Participation by EEA firms)</u>).</del>
Delete the following definitions. The text is not shown struck through.		
<i>DGD claim</i>		a <i>claim</i> , in relation to a <i>protected deposit</i> , against a <i>CRD credit institution</i> , whether established in the <i>United Kingdom</i> or in another <i>EEA State</i> .
<i>professional indemnity insurance contract</i>		a <i>contract of insurance</i> against the risk of the person insured incurring liability to a third party arising out of the insured's business activities.
<i>protected contract of insurance</i>		a <i>contract of insurance</i> which is covered by the <i>compensation scheme</i> , as defined in <i>COMP 5.4.1R</i> .
<i>protected deposit</i>		a <i>deposit</i> which is covered by the <i>compensation scheme</i> , as defined in <i>COMP 5.3.1R</i> .
<i>relevant net premium income</i>	(1)	(in relation to business which is not <i>occupational pension fund management business</i> ) the premium income in respect of

*protected contracts of insurance of a firm; or*

- (2) (in relation to *occupational pension fund management business*)  
the *remuneration* retained by a *firm* in relation to its carrying on  
*occupational pension fund management business*

in the year preceding that in which the date for submission of the  
information under *FEES* 6.5.13R falls, net of any relevant rebates or  
refunds.

## Annex B

### Amendments to the General Provisions (GEN)

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

#### 2.2        **Interpreting the Handbook**

...

Application of provisions made by both the FCA and the PRA

...

2.2.25    G    Examples of rules being interpreted as cut back by *GEN* 2.2.23R include the following:

...

- (3)    ~~*COMP 5.2.1R* sets out types of *protected claims* to be covered by the *FSCS*. The powers of the *FCA* to make this type of *rule* are set out in the order made under section 213(1A) of the *Act*. The *rule* must be read as applying only to the extent of those powers. For example, the *FCA* has no power to make *COMP 5.2.1R(1)* as creating *protected claims* for a *protected deposit*. As such, those provisions are to be interpreted as not applied by the *FCA*. [deleted]~~

[*Editor's note:* The text in this Annex takes account of the changes suggested by CP15/43 *Markets in Financial Instruments Directive II Implementation* (December 2015) as if they were made.]

## Annex C

### 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 the date of this instrument**

**TP 14      Transitional provisions relating to statements provided by participant firms before 1 April 2018 with respect to the FSCS 2018/19 financial year**

<u>(1)</u>	<u>(2)</u> <b><u>Material to which the transitional provision applies</u></b>	<u>(3)</u>	<u>(4)</u> <b><u>Transitional Provision</u></b>	<u>(5)</u> <b><u>Transitional provision: dates in force</u></b>	<u>(6)</u> <b><u>Handbook Provisions coming into force</u></b>
<u>14</u>	<u>FEES 6.5.13R</u>	<u>R</u>	<u>For the purposes of statements provided by <i>participant firms</i> under <i>FEES</i> 6.5.13R before 1 April 2018 and with respect to the <i>financial year</i> of the <i>compensation scheme</i> beginning on 1 April 2018, references in <i>FEES</i> 6.5.13R to <i>classes</i> must be read as references to <i>classes</i> to which <i>firms</i> will belong after 31 March 2018; and references to <i>tariffs</i> must be read as references to <i>tariffs</i> as in force after 31 March 2018.</u>	<u>From [date of instrument] to 31 March 2018</u>	<u>1 April 2018</u>

**Part 2: comes into force on 1 April 2018**

**6            Financial Services Compensation Scheme Funding**

...

**6.1        Application**

...

- 6.1.2 G (1) ...
- (2) ~~Although a member is a participant firm for the purposes of most provisions of COMP, a member is excluded from the definition of participant firm for the purposes of FEES 6 (see definition of participant firm in Glossary). This is because the~~ The fees levied in relation to the carrying on of insurance market activities by members will be imposed on the Society rather than individually on each member (see FEES 6.3.24R).

## Purpose

- 6.1.3 G The purpose of this chapter is to set out the requirements on *participant firms* to pay levies imposed by the *FSCS* to provide funding for its functions under the Compensation sourcebook (*COMP*). The *PRA Rulebook* deals with funding for the *FSCS*'s functions for depositor protection and policyholder protection.

...

- 6.1.6 G In calculating a *compensation costs levy*, the *FSCS*:
- (1) ~~for claims for protected deposits, may include compensation costs expected in the 12-month period following the date of the levy; and~~
- (2) ~~for other protected claims, may include up to the greater of one third of the compensation costs expected in the 36-month period following the date of the levy~~ 1 April of the financial year of the compensation scheme in relation to which the levy is imposed, or the compensation costs expected in the 12 months following that date.
- 6.1.6A G The total amount of all *management expenses levies* attributable to a ~~financial year~~ financial year and levied by the *FSCS* under this chapter or under the *PRA Rulebook* will be restricted to the amount set out on an annual basis in *FEES 6 Annex 1R*.
- 6.1.7A G In order to allocate a share of the amount of *specific costs* and *compensation costs* to be funded by an individual *participant firm*, the funding arrangements are split into ~~twelve~~ ten *classes*: ~~the deposits class; the life and pensions provision class; the general insurance provision class; the investment provision class; the life and pensions intermediation class; the home finance intermediation class;~~ the investment and structured deposits intermediation class; the general insurance intermediation class; the deposit acceptor's contribution class; the insurers - life contribution class; the insurers - general contribution class; and the home finance providers and administrators' contribution class and the debt management claims class. The *permissions* held by a *participant firm* determine into which *class*, or *classes*, it falls.

- 6.1.8 G The provisions on the allocation of levies to *classes up to their levy limits* meet a requirement of section 213(5) of the *Act* that the ~~*appropriate regulator FCA*~~, in making rules to enable the *FSCS* to impose levies, must take account of the desirability of ensuring that the amount of the levies imposed on a particular class of *authorised person* reflects, so far as practicable, the amount of claims made, or likely to be made, in respect of that class of person.

The management expenses levy

- 6.1.9 G Section 223 of the *Act* (Management expenses) prevents the *FSCS* from recovering, through a levy, any *management expenses* attributable to a particular period in excess of the limit set in *COMP* as applicable to that period. 'Management expenses' are defined in section 223(3) to mean expenses incurred or expected to be incurred by the *FSCS* in connection with its functions under the *Act*, except:
- (1) expenses incurred in paying compensation;
  - (2) expenses incurred as a result of the *FSCS* making the arrangements to secure continuity of insurance ~~set out in *COMP* 3.3.1R and *COMP* 3.3.2R~~ or ~~taking the measures set out in *COMP* 3.3.3R and *COMP* 3.3.4R~~ when a *relevant person* is an *insurer* in financial difficulties to make payments to or in respect of policyholders or to safeguard policyholders, under *PRA* rules made under sections 216(3) or (4), 217(1) or 217(6) of the *Act*;
  - (3) expenses incurred under section 214B or section 214D of the *Act* as a result of the *FSCS* being required by HM Treasury to make payments in connection with the exercise of the stabilisation power under Part 1 of the Banking Act 2009; and
  - (4) expenses incurred under Part XVA of the *Act* as a result of the *FSCS* being required by HM Treasury to act in relation to a *relevant scheme*.
- 6.1.10 G A *management expenses levy* may consist of two elements. The first is a *base costs levy*, for 50% of the base costs of running the *compensation scheme* in a ~~financial year~~ *financial year*, that is, costs which are not dependent upon the level of activity of the *compensation scheme* and which therefore are not attributable to any specific *class*. The *PRA* allocates the other 50% of the base costs under its rules. Included in ~~this category~~ base costs are items such as the salary of the members of the board of the *FSCS*, the costs of the premises which the *FSCS* occupies, and its audit fees. It would also likely include the cost of any insurance cover secured by *FSCS* against the risk of it paying claims out in circumstances where the *levy limit* of the particular *class* to which the claim would otherwise be attributable has exceeded its *levy limit* for the year, as the insurance cover is likely to benefit all *classes* which may have costs allocated to them if the *levy limit* of another *class* is breached. The amount that each *participant firm* pays towards a *base costs levy* is calculated by reference to the *regulatory costs* paid by the *firm*.

All *participant firms* are liable to contribute towards a *base costs levy*.

- 6.1.11A G The second element of a *management expenses levy* is a *specific costs levy* for the “specific costs” of running the *compensation scheme* in a ~~financial year~~ financial year. These costs are attributable to a *class*, and include the salary costs of certain staff of the *FSCS* and claims handling and legal and other professional fees. It also may include the cost of any insurance cover that *FSCS* secures against the risk of *FSCS* paying out claims above a given level in any particular *class* (but below the *levy limit* for that *class* for the year). ~~The specific costs are attributed to the class which is responsible for those costs.~~ When the *FSCS* imposes a *specific costs levy*, the levy is allocated to the *class* which ~~is responsible for~~ gives rise to those costs, up to the relevant *levy limits*. *Specific costs* attributable to certain *classes*, which exceed the *class levy limits*, may be allocated to the *retail pool*. The *FSCS* may include in a *specific costs levy* the *specific costs* that the *FSCS* expects to incur (including in respect of defaults not yet declared at the date of the levy) during the ~~financial year~~ financial year of the *compensation scheme* to which the levy relates. The amount that each *participant firm* pays towards the *specific costs levy* is calculated by reference to the amount of business conducted by the *firm* in each of the *classes* to which the *FSCS* has allocated *specific costs*. Each *class* has a separate “tariff base” for this purpose, set out in *FEES 6 Annex 3AR*. *Participant firms* may be exempt from contributing to the *specific costs levy*.

...

- 6.1.13 G The limit on the *management expenses* attributable to the forthcoming ~~financial year~~ financial year of the *FSCS*: compensation scheme will be consulted on in January each year.

The compensation costs levy

- 6.1.14 G In imposing a *compensation costs levy* in each ~~financial year~~ financial year of the *compensation scheme* the *FSCS* will take into account the *compensation costs* which the *FSCS* has incurred and has not yet raised through levies, any recoveries it has had made using the rights that have been assigned to it or to which it is subrogated and a further amount calculated taking into account:
- (1) ~~for claims for protected deposits, those compensation costs it expects to incur (including in respect of defaults yet to be declared) in the 12 months following the date of the levy; and [deleted]~~
  - (2) ~~for other protected claims: [deleted]~~
  - (a) the *compensation costs* it expects to incur in the ~~12 months following the date of the levy~~ financial year of the compensation scheme in
  - (3) relation to which the levy is imposed; or, if greater
  - (b) one third of the *compensation costs* it expects to incur in the 36 ~~months following the date of the levy~~ 1 April of the financial year of

(4) the compensation scheme in relation to which the levy is imposed (see FEES 6.3.1R (Imposing management expenses and compensation costs levies)).

6.1.15 G *Compensation costs* are principally the costs incurred in paying compensation. Costs incurred:

- (1) ~~in securing continuity of long term insurance; or [deleted]~~
- (2) ~~in safeguarding eligible claimants when insurers are in financial difficulties; or [deleted]~~
- (3) ~~in making payments or giving indemnities under COMP 11.2.3R; or [deleted]~~
- (4) as a result of the FSCS being required by HM Treasury to make payments in connection with the exercise of the stabilisation power under Part 1 of the Banking Act 2009; or
- (5) in paying interest, principal and other costs from borrowing to allow the FSCS to pay claims attributable to a particular *class*;

are also treated as *compensation costs*. *Compensation costs* are attributed to the *class* which ~~is responsible for~~ gives rise to the costs. ~~When the FSCS imposes a compensation costs levy the levy is allocated to the class which is responsible for the costs~~ up to relevant *levy limits*. Certain *classes* may be funded, for *compensation costs levies* beyond the *class levy limit*, by the *retail pool*.

Participant firms that are members of more than one class

6.1.16 G If a *participant firm* is a member of more than one *class*, the total *compensation costs levy* and *specific costs levy* for that *firm* in a particular year will be the aggregate of the individual levies calculated for the *firm* in respect of each of the *classes* for that year. Each *class* has a *levy limit* which is the maximum amount of *compensation costs* and *specific costs* which may be allocated to a particular *class* in a ~~financial year~~ financial year for the purposes of a levy.

The retail pool

6.1.16A G The FCA has made *rules* providing that *compensation costs* and *specific costs* attributable to the intermediation classes, and the investment provision class and the debt management claims class, and which exceed the *class levy limits*, may be allocated to the *retail pool*. Levies allocated to the *retail pool* are then allocated amongst the other such *classes*, together with certain *classes* (known as *FCA provider contribution classes*) (see FEES 6 Annex 5R). The *FCA provider contribution classes* may contribute to *compensation costs levies* or *specific costs levies* funded by the *retail pool*, but not themselves receive any such funding. The *FCA provider contribution classes* have a different tariff structure to the other *classes*, based either on

regulatory costs or the PRA Rulebook (see ~~FEES 6.5A.6R~~ 6 Annex 3AR).

...

## 6.2 Exemption

- 6.2.1A R (1) Except as set out in (3), a *participant firm* which does not conduct business ~~that could give rise to a *protected claim* by an eligible claimant~~ in respect of which the FSCS may pay compensation and has no reasonable likelihood of doing so is exempt from a *specific costs levy*, or a *compensation costs levy*, or both, provided that:
- ...
- ...
- 6.2.2 R ~~FEES 6.2.1R~~ 6.2.1AR does not apply to a *participant firm* that may be subject to a claim under *COMP 3.2.4R*.
- 6.2.3 G A *participant firm* to which ~~FEES 6.2.2R~~ COMP 3.2.4R applies must report *annual eligible income* in accordance with *FEES 6.5.13R*. Such a *participant firm* may take advantage of the option to report its annual income attributable to business ~~conducted with or on behalf of eligible claimants~~ in respect of which the FSCS may pay compensation.
- 6.2.4 R A *participant firm* which is exempt under ~~FEES 6.2.1R~~ 6.2.1AR must notify the FSCS in writing as soon as reasonably practicable if the conditions in ~~FEES 6.2.1R~~ 6.2.1AR no longer apply.
- 6.2.5 G A *participant firm* to which the conditions in ~~FEES 6.2.1R~~ 6.2.1AR no longer apply will then become subject to *FEES 6.3*.
- 6.2.6 R If a *participant firm* ceases to conduct business that could give rise to a *protected claim* by an *eligible claimant* and notifies the FSCS of this under ~~FEES 6.2.1R(1)~~ 6.2.1AR, it will be treated as a *participant firm* to which *FEES 6.7.6R* applies until the end of the ~~financial year~~ financial year of the *compensation scheme* in which the notice was given.
- 6.2.7 G The financial year of the *compensation scheme* is the twelve months ending on 31 March. The effect of *FEES 6.2.6R* and ~~FEES 6.2.1R(2)~~ 6.2.1AR is that if a *firm* fails to notify FSCS of an exemption under ~~FEES 6.2.1R~~ 6.2.1AR by 31 March it will be treated as non-exempt for the whole of the next ~~financial year~~ financial year.
- 6.2.8 R For the purposes of ~~FEES 6.2.1R~~ 6.2.1AR a *participant firm* will only be exempt from a *specific costs levy* or *compensation costs levy* for any given ~~financial year~~ financial year if it met the conditions in ~~FEES 6.2.1R~~ 6.2.1AR on 31 March of the immediately preceding ~~financial year~~ financial year.

### 6.3 The FSCS's power to impose levies

Imposing management expenses and compensation costs levies

- 6.3.1 R The *FSCS* may at any time impose a *management expenses levy* or a *compensation costs levy*, provided that the *FSCS* has reasonable grounds for believing that the funds available to it to meet relevant expenses are, or will be, insufficient, taking into account expenditure already incurred, actual and expected recoveries and:
- (1) in the case of a *management expenses levy*, the level of the *FSCS*'s expected expenditure in respect of those expenses in the ~~financial year~~ financial year of the *compensation scheme* in relation to which the levy is imposed; and
  - (2) ~~in the case of a *compensation costs levy* relating to *claims* for *protected deposits*, the level of the *FSCS*'s expected expenditure in respect of *compensation costs* in the 12 months immediately following the levy; and [deleted]~~
  - (3) in the case of a *compensation costs levy* ~~relating to other *protected claims*; ;~~
    - (a) the *FSCS*'s expenditure in respect of *compensation costs* expected in the 12 months following the levy of the financial year of the compensation scheme in relation to which the levy is imposed; or, if greater
    - (b) one third of the *FSCS*'s expenditure in respect of *compensation costs* expected in the 36 months following the levy 1 April in the financial year of the compensation scheme in relation to which the levy is imposed.
- ...
- 6.3.2A G The *FSCS* will usually levy once in each ~~financial year (and in respect of *compensation costs*, for expenditure expected in the 12 months or, if greater, one third of the expenditure expected in the period of 36 months following 1 July in that year)~~ financial year. 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~~ financial year, do one or more of the following:
- ...
- 6.3.3 G The *FSCS* has committed itself in a Memorandum of Understanding with ~~each of the *FCA* and the *PRA*~~ to publish its policy in respect of levying.
- ...

- 6.3.4A R The *FSCS* may at any time impose a *MERS levy* provided that the *FSCS* has reasonable grounds for believing that the funds available to it to meet relevant expenses are or will be insufficient, taking into account relevant expenses incurred or expected to be incurred in the ~~12 months following the date of the levy~~ financial year of the compensation scheme in relation to which the levy is imposed.

Limits on compensation costs and specific costs levies on classes

- 6.3.5 R The maximum aggregate amount of *compensation costs* and *specific costs* for which the *FSCS* can levy each *class* (not including the *FCA provider contribution classes*) in any one ~~financial year~~ financial year of the *compensation scheme* is limited to the amounts set out in the table in *FEES* 6 Annex 2R.

[Note: the levy limits for the FCA provider contribution classes are set out in FEES 6 Annex 5R]

...

Management of funds

- 6.3.11 R The *FSCS* must hold any amount collected from a *specific costs levy* or *compensation costs levy* to the credit of the *classes* in accordance with the allocation established under *FEES* ~~6.4.6R~~ 6.4.6AR and *FEES* ~~6.5.2R~~ 6.5.2-AR.

...

Firms acquiring businesses from other firms

- 6.3.22C R (1) This *rule* applies to the calculation of the levies of a *firm* (A) if:
- (a) either:
- ...
- (ii) A became authorised as a result of B's simple change of legal status (as defined in *FEES* 3 Annex ~~1R~~ Part 6);
- ...
- ...
- (3) This *rule* only applies in respect of those ~~financial years~~ financial years of the *FSCS compensation scheme* for which A's levies are calculated on the basis of a statement of business under *FEES* 6.5.13R drawn up to a date, or as of a date, before the acquisition or change in legal status took place.

Remission of levy ~~or additional administrative fee~~

- 6.3.23 R If a *participant firm's* share of a levy ~~or an additional administrative fee~~ under ~~FEES 6.7.4R~~ would be so small that, in the opinion of the *FSCS*, the costs of collection would be disproportionate to the amount payable, the *FSCS* may treat the *participant firm* as if its share of the levy ~~or additional administrative fee~~ amounted to zero.

Levies on the Society of Lloyd's

- 6.3.24 R The *FSCS* may impose a levy on the *Society* to be calculated as the aggregate of the levies that would be imposed on each *member* if this chapter applied to *members*, as follows:
- (1) a share of the *base costs levy* for each *financial year*; and
  - (2) a share of a *specific costs levy* or a *compensation costs levy* allocated to the insurers – life contribution *class* or insurers – general contribution *class* in the *retail pool* in accordance with this chapter.

## 6.4 Management expenses

...

Limit on management expenses

- 6.4.2 R The total of all *management expenses levies* (taken together with the management expenses levies under the *PRA's Rulebook*) attributable to a particular period of the *compensation scheme* may not exceed the limit applicable to that period set out in *FEES 6 Annex 1R*.

...

Base costs levy

- 6.4.5 R Subject to *FEES 6.3.22R*, the *FSCS* must calculate a *participant firm's* share of a *base costs levy* by:
- (1) identifying the *base costs* which the *FSCS* has incurred, or expects to incur, in the relevant ~~financial year~~ *financial year* of the *compensation scheme*, but has not yet levied, and:
    - (a) ~~allocating 50% of those *base costs* as the sum to be levied on participants in activity groups A.1, A.3, A.4, A.5 and A.6 (as listed in *FEES 4 Annex 1BR*); and~~
    - (b) allocating 50% of those ~~base costs~~ *base costs* as the sum to be levied on participants in all the activity groups listed in *FEES 4 Annex 1AR*;
  - (2) calculating the amount of the *participant firm's* ~~regulatory costs~~ *regulatory costs* as a proportion of the total *regulatory costs* relating to

all *participant firms* for the relevant ~~financial year~~; financial year; and

(a) ~~if the *participant firm* belongs to any of the activity groups in (1)(a), imposed by the *PRA* in respect of those groups; and~~

(b) ~~if the *participant firm* belongs to any of the activity groups in (1)(b), imposed by the *FCA* in respect of those groups; and~~

(3) applying the proportion calculated in (2)(a), ~~if any to the sum in (1)(a), and the proportion calculated in (2)(b) (if any)~~ to the sum in (1)(b).

6.4.5A G The effect of *FEES* 6.4.5R is that if a *participant firm* belongs to activity groups in both (1)(a) and (1)(b) of that rule, it will be required to pay a share of the *base costs levy* in respect of both sets of activity groups. ~~[deleted]~~

6.4.5B G The *FCA* and the *PRA* each allocate 50% of the *base costs* in a given *financial year* of the *compensation scheme* in accordance with their respective rules.

#### Specific costs levy

6.4.6A R The *FSCS* must allocate any *specific costs levy*:

...

(2) thereafter, where the *levy limit* has been reached (whether as a result of *compensation costs* or *specific costs* or both) for a *class* whose attributable costs may be allocated to the *retail pool* (see *FEES* 6 Annex 5 5R), to the *retail pool*, in accordance with and subject to *FEES* 6.5A.

6.4.7A R The *FSCS* must calculate a *participant firm's* share of a *specific costs levy* (subject to *FEES* 6.3.22R (Adjustment to calculation of levy shares) ) by:

...

(2) identifying the *management expenses* other than *base costs* which the *FSCS* has incurred, or expects to incur, in the relevant ~~financial year~~ financial year of the *compensation scheme*, allocated to the *classes* identified in (1), but not yet levied;

(3) calculating, in relation to each relevant *class*, the *participant firm's* tariff base (see *FEES* 6 Annex 3A 3AR) as a proportion of the total tariff base of all *participant firms* in the *class*, ~~using the statement of business most recently supplied under *FEES* 6.5.13R (but this paragraph is modified for a *specific costs levy* allocated to an *FCA provider contribution class* in the *retail pool* by *FEES* 6.5A.6R);~~

...

#### New participant firms

6.4.8 R A *firm* which becomes a *participant firm* part way through a ~~financial year~~ financial year of the *compensation scheme* will not be liable to pay a share of a *specific costs levy* made in that year.

...

6.4.10 G Since a *firm* that becomes a *participant firm* in the course of a ~~financial year~~ financial year of the *compensation scheme* will already be obtaining a discount in relation to the *base costs levy* through the modified fee provisions of *FEES* 4.2.6R, no *rule* is necessary in *FEES* 6 for discounts on the *base costs levy*.

...

#### Specific costs levy for newly authorised firms

6.4.10A R (1) This *rule* deals with the calculation of:

- (a) a *participant firm*'s *specific costs levy* in the ~~financial year~~ financial year of the ~~FSCS compensation scheme~~ following the ~~FSCS financial year~~ financial year of the compensation scheme in which it became a *participant firm*; or
- (b) a *participant firm*'s *specific costs levy* in the ~~financial year~~ financial year of the ~~FSCS compensation scheme~~ in which it had its *permission* extended, and the following ~~FSCS financial year~~ financial year of the compensation scheme; and
- (c) the tariff base for the *classes* that relate to the relevant *permissions* or extensions, as the case may be.

...

(3) The rest of this *rule* only applies to a *firm* that becomes a *participant firm*, or extends its *permission*, on or after 1 April 2009.

...

- (b) If a *participant firm* satisfies the following conditions it must calculate its tariff base under (c) for the ~~FSCS financial year~~ financial year following the ~~FSCS financial year~~ financial year of the compensation scheme it became a *participant firm*:
  - (i) it became a *participant firm* or receives its extension of *permission*, as the case may be, between 1 April and 31 December inclusive; and
  - (ii) its tariff base, but for this *rule*, is calculated by reference to the ~~financial year~~ financial year ended in the calendar year ending 31 December or the twelve *months* ending 31 December before the ~~FSCS financial~~

~~year~~ financial year of the compensation scheme.

- (c) If a *participant firm* satisfies the conditions in (b) it must calculate its tariff base as follows:
- (i) ...
- (ii) the tariff is calculated by reference to the period beginning on the date it became a *participant firm* or had its *permission* extended, and ending on the 31 December before the start of the ~~FSCS financial year~~ financial year of the compensation scheme; and
- ...
- ...
- (e) Where a *participant firm* is required to use actual data under this rule, ~~FEES 6 Annex 3R 3AR~~ is disapplied, to the extent it is incompatible, in relation to the calculation of that *participant firm's* valuation date in its second ~~financial year~~ financial year.

#### Application of FEES 6.4.10AR

- 6.4.10B G The table below sets out the period within which a *participant firm's* tariff base is calculated ("the data period") for second year levies calculated under ~~FEES 6.4.10B~~ 6.4.10AR. The example is based on a *participant firm* that extends its *permission* on 1 November 2009 and has a financial year ending 31 March.

References in this table to dates or months are references to the latest one occurring before the start of the ~~FSCS financial year~~ financial year of the compensation scheme unless otherwise stated.

Type of permission acquired on 1 November	Tariff base	Valuation date but for <del>FEES 6.5.13BR</del> <u>6.4.10AR</u>	Data period under <del>FEES 6.5.13bR</del> <u>6.4.10AR</u>
<i>Accepting deposits</i>	<del>Protected deposits</del>	As at 31 December 2009	As at 31 December 2009
<i>Effecting contracts of insurance</i> ( <del>Insurers general</del> )	<i>Relevant net premium income</i>	The <i>firm's</i> tariff base calculated in the year 2009 – so projected valuation will be used.	1 November to 31 December 2009
<i>Dealing in investments as agent</i> in relation to	<i>Annual eligible income</i>	Financial year ended 31 March 2009 - so projected	1 November to 31 December

General Insurance Intermediation		valuations will be used.	2009
----------------------------------	--	--------------------------	------

...

## 6.5 Compensation costs

...

Allocation: ~~all classes except A, B and C~~

6.5.2-A R The *FSCS* must allocate any *compensation costs levy*:

...

- (2) thereafter, where the *levy limit* has been reached (whether as a result of *compensation costs* or *specific costs* or both) for a *class* whose attributable costs may be allocated to the *retail pool* (see *FEES* 6 Annex 5 5R), to the *retail pool*, in accordance with, and subject to, *FEES* 6.5A.

...

6.5.6A R The *FSCS* must calculate each *participant firm's* share of a *compensation costs levy* (subject to *FEES* 6.3.22R (Adjustments to calculation of levy shares)) by:

...

- (2) identifying the *compensation costs* falling within *FEES* ~~6.5.1R~~ 6.3.1R allocated, in accordance with *FEES* ~~6.5.2R~~ 6.5.2-AR, to the *classes* identified in (1);
- (3) calculating, in relation to each relevant *class*, the *participant firm's* tariff base (see *FEES* 6 Annex ~~3A~~ 3AR) as a proportion of the total tariff base of all *participant firms* in the *class*, ~~using the statement of business most recently supplied under *FEES* 6.5.13R (but this paragraph is modified for a *compensation costs levy* allocated to an *FCA provider contribution class* in the *retail pool* by *FEES* 6.5A.6R);~~

...

Classes and tariff bases for compensation cost levies and specific costs levies

6.5.8 G *Guidance* on parts of *FEES* 6 Annex ~~3R~~ 3AR can be found in *FEES* 6 Annex 4G.

New participant firms

6.5.9 R A *firm* which becomes a *participant firm* part way through a ~~financial year~~ financial year of the *compensation scheme* will not be liable to pay a share

of the *compensation costs levy* made in that year.

...

#### Reporting requirements

- 6.5.13 R (1) Unless exempt under ~~FEES 6.2.1R~~ or FEES 6.2.1AR, a *participant firm* must provide the *FSCS* by the end of February each year (or, if it has become a *participant firm* part way through the ~~financial year~~ *financial year*, by the date requested by the ~~appropriate regulator~~ *FCA*) with a statement of:
- (a) *classes* to which it belongs; and
  - (b) the total amount of business (measured in accordance with the appropriate tariff base or tariff bases) which it conducted, in respect of the most recent valuation period (as specified by FEES 6 Annex ~~3R~~ *3AR* (Financial Services Compensation Scheme - classes)) ending before the relevant year in relation to each of ~~those~~ the classes in (i), (ii) and (iii):
    - (i) the insurers – general contribution class but only where the participant firm is the Society; and
    - (ii) the insurers – life contribution class but only where the participant firm is the Society; and
    - (ii) all other classes except the FCA provider contribution classes.

...

- 6.5.13A G For example, when the tariff base for a particular *class* is based on a *firm's annual eligible income* the valuation period for that *class* is the *firm's* last financial year ending in the year to 31 December preceding the ~~financial year~~ *financial year* of the *FSCS compensation scheme* for which the calculation is being made. ~~In the case of a firm in class A1 (Deposits) its valuation period will be 31 December.~~

- 6.5.14 R If the information in FEES 6.5.13R has been provided to the ~~appropriate regulator~~ *FCA* under other *rule* obligations, a *participant firm* will be deemed to have complied with FEES 6.5.13R.

...

- 6.5.16 R If a *participant firm* does not submit a complete statement by the date on which it is due in accordance with FEES 6.5.13R and any prescribed submission procedures:
- (1) the *firm* must pay an administrative fee of £250 (but not if it is already subject to an administrative fee under FEES 4 Annex 2AR, Part 1 or

*FEES* 5.4.1R for the same ~~financial year~~ *financial year*); and

- (2) the *compensation costs levy* and any *specific costs levy* will be calculated using (where relevant) the valuation or valuations of business applicable to the previous period, multiplied by the factor of 1.10 (or, if it has become a *participant firm* part way through a ~~financial year~~ *financial year*, on the basis of information provided to the ~~appropriate regulator~~ *FCA* for the purposes of *FEES* 4.4.2R) or on any other reasonable basis, making such adjustments as seem appropriate in subsequent levies once the true figures are known.

...

## 6.5A The retail pool

Allocation of compensation costs levies and specific costs levies through the retail pool

- 6.5A.1 R The *FSCS* must allocate a *compensation costs levy* or *specific costs levy*, which has been allocated to the *retail pool* (under *FEES* 6.5.2-AR(2) or *FEES* 6.4.6AR(2)):

- (1) ...
- (2) in proportion to the relative sizes of the *retail pool* levy limits of the *classes* in (1) and up to those levy limits; and
- (3) in accordance with the table in *FEES* 6 Annex 5 5R.

[**Note:** The *retail pool* levy limits for *classes* other than the *FCA provider contribution classes* are the normal *levy limits* for that *class*. See the table in *FEES* 6 Annex 5 5R for the *retail pool* levy limits for all relevant *classes*.]

### Effect of levies under PRA's rules on insurers and deposit-takers in the retail pool

- 6.5A.2 R (1) An allocation in *FEES* 6.5A.1R to an *FCA provider contribution class* other than the home finance providers and administrators' contribution *class* may not be of an amount that, if it were added to any levies:
- (a) that correspond to the *FCA's* compensation costs levies or specific costs levies; and
- (b) which have previously in the same financial year been imposed on the *PRA* funding ~~class~~ class which corresponds to that *FCA provider contribution class* (as set out in *FEES* 6.5A.7R),
- the combined figure would be greater than ~~the levy limit~~ any levy limit of the corresponding *PRA* funding ~~class~~ class.
- (2) Where:
- (a) an *FCA provider contribution class* has already contributed to

*specific costs or compensation costs (through the retail pool) in a financial year; and*

- (b) if the amount of that previous contribution by the *class* in (a) were added to a levy that corresponds to the FCA's compensation costs levy or specific costs levy and which is being imposed on the *PRA funding class* which corresponds to the *class* in (a) (and any previous such levies in the same financial year), the combined figure would be greater than ~~the~~ levy limit any levy limit of the corresponding *PRA funding class* class;

the *FSCS* must, so far as reasonably possible, obtain repayment of the previous contribution by the *class* in (a) from the *retail pool* (including the *FCA provider contribution classes* except the *class* in (a)) to the extent that ensures that the combined figure in (b) would no longer be greater than ~~the~~ levy limit any levy limit of the corresponding *PRA funding class* class, and credit the repayment to the *class* in (a).

...

[**Note 1:** the home finance providers and administrators' contribution *class* ~~does~~ and the debt management claims class do not have a corresponding *PRA funding class* class.]

[**Note 2:** the levy limits for the corresponding PRA funding classes are contained in the *PRA Rulebook*.]

- 6.5A.3 G In considering which of the options in *FEES* 6.5A.2R(2) (3) to adopt, the *FSCS* will generally impose a levy, rather than borrow or utilise funds as described in ~~FEES 6.5A.2R(2)(e)~~ *FEES* 6.5A.2R(3)(c), unless the latter options appear to be preferable in the specific circumstances prevailing at the relevant time.

#### How levy limits affect allocation to classes in the retail pool

- 6.5A.4 R ...

...

~~Calculation of participant firms' shares in levies allocated to classes in the retail pool~~

- 6.5A.6 R ~~In relation to a *specific costs levy* or *compensation costs levy* allocated to an *FCA provider contribution class* in the *retail pool*, *FEES* 6.4.7AR(3) and *FEES* 6.5.6AR(3), respectively, are replaced by the following: "calculating, in relation to each relevant *class*, the *participant firm's* most recent *regulatory costs* arising from its membership of the corresponding activity group (as listed in *FEES* 4 Annex 1AR) set out in *FEES* 6.5A.7R, as a proportion of the total most recent *regulatory costs* of all *participant firms* in that activity group arising from their membership of that group;".~~ [deleted]

- 6.5A.7 R The corresponding *PRA funding classes* and corresponding activity groups referred to in *FEES 6.5A.2R* and *FEES 6.5A.6R* respectively are as follows:  
[deleted]

<b>FCA provider contribution class</b>	<b>Corresponding PRA funding class</b>	<b>Corresponding activity group</b>
Deposit acceptor's contribution class	Deposits	A.1: Deposit acceptors
Insurers – life contribution class	Life and pensions provision	A.4: Insurers – life
Insurers – general contribution class	General insurance provision	A.3: Insurers – general
Home finance providers and administrators' contribution class	None	A.2: Home finance providers and administrators

## 6.6 Incoming EEA firms

- 6.6.1 R If an *incoming EEA firm*, which is a ~~CRD credit institution~~, an *IMD insurance intermediary*, an *MCD mortgage credit intermediary* or a *MiFID investment firm*, is a *participant firm*, the *FSCS* must give the *firm* such discount (if any) as is appropriate on the share of any levy it would otherwise be required to pay, taking account of the nature of the levy and the extent of the compensation coverage provided by the firm's *Home State* scheme.

## 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 by *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 payable for the previous *financial year* of the *compensation scheme*; and
  - (2) by 1 September the balance of the levy due from the *participant firm* for the current *financial year* of the *compensation scheme*.

### Payments of levy by other firms

- 6.7.1 R A participant firm other than a participant firm that falls within FEES 6.7.-1R, must pay its share of any levy made by the *FSCS*:
- (1) in one payment; ~~or~~
  - (2) ~~where the FSCS agrees, quarterly, at the beginning of each quarter, by direct debit agreement.~~
- 6.7.2 G ~~The amount paid under a direct debit agreement arrangement will be adjusted on a continuous basis to take account of interim levies and other adjustments made during the course of the financial year. [deleted]~~
- 6.7.3 R A *participant firm*'s share of a levy to which ~~FEES 6.7.1R(1)~~ 6.7.1R applies is due on, and payable within 30 *days* of, the date when the invoice is issued.

#### Payments of interim levies

- 6.7.3A R A participant firm's share of any interim levy is due on, and payable within 30 days of, the date when the invoice is issued.
- 6.7.4 R ~~If a participant firm does not pay its share of a levy subject to a direct debit arrangement as required by FEES 6.7.1R(2), the entire amount of the levy becomes due and payable to the FSCS, and additional administrative fees are payable at the rate set out in FEES 2.2.1R. [deleted]~~

#### Method of Payment

- 6.7.5 R A *participant firm* liable to pay its share of the levy under FEES 6.7.-1R, 6.7.1R and 6.7.3R must do so using one of the methods set out in FEES 4.2.4R save that no additional amount or discount is applicable.

#### Firms ceasing to be a participant firm

- 6.7.6 R If a *firm* ceases to be a *participant firm* or carry out activities within one or more *classes* part way through a ~~financial year~~ financial year of the *compensation scheme*:
- (1) ...
  - (2) the *FSCS* may make one or more levies upon it (which may be before or after the *firm* has ceased to be a *participant firm* or carry out activities within one or more *classes*, but must be before it ceases to be an *authorised person*) for the costs which it would have been liable to pay had the *FSCS* made a levy on all *participant firms* or *firms* carrying out activities within that *class* in the ~~financial year~~ financial year it ceased to be a *participant firm* or carry out activities within that *class*.

...

## **6 Annex Financial Services Compensation Scheme - annual levy limits**

2R

This table belongs to *FEES* 6.3.5R and ~~*FEES* TP 2.5.2R~~

Class	Levy Limit (£ million)
A: Deposits	1,500
<del>B1: General insurance provision</del>	<del>600</del>
B2: General insurance intermediation	300
<del>C1: Life and pensions provision</del>	<del>690</del>
C2: Life and pensions intermediation	100
D1: Investment provision	200
D2: Investment <u>and Structured Deposits</u> intermediation	150
E2: Home finance intermediation	40
<u>K: Debt management claims</u>	<u>45</u>

...

### 6 Annex 3AR Financial Services Compensation Scheme – classes

This table belongs to *FEES* 6.4.7AR and *FEES* 6.5.6AR

Class A	Deposits [deleted]
<b>Firms with permission for:</b>	<i>accepting deposits and/or operating a dormant account fund. BUT does not include any fee payer who either effects or carries out contracts of insurance.</i>
<b>Tariff base</b>	(1) <i>Protected deposits and/or</i> (2) <i>Protected dormant accounts multiplied by 0.2 as at 31 December. Except where paragraph (4) says otherwise, protected deposits must be adjusted as follows:</i>
	(1) <i>Only include a protected deposit to the extent that an eligible claimant would have a claim in respect of it.</i>
	(2) <i>Exclude any amount in respect of which the FSCS would not pay compensation due to the maximum payment limits in COMP 10.2.</i>
	(3) <i>The tariff base calculation is made on the basis of the information that the firm would have to include in the single customer views it has to be able to produce under COMP 17 (Systems requirements for firms that accept deposits). The</i>

	information must be of the extent and standard required if the <i>firm</i> was preparing the <i>single customer views</i> as at the valuation date for the tariff base (31 December).
	(4) (a) If this paragraph applies, the adjustments in (1) to (3) do not apply and the calculation is based on <i>protected deposits</i> .
	(b) This paragraph applies with respect to a <i>protected deposit</i> to the extent that, under <i>COMP 17</i> , the <i>firm</i> does not have to identify an eligible claimant with respect to that <i>protected deposit</i> because the account is held by the account holder on behalf of others.
	(c) This paragraph applies with respect to a <i>protected deposit</i> that has been excluded from the <i>single customer view</i> because it is an account that is not active, as defined in <i>COMP 17.2.3R(2)</i> .

	General Insurance
<b>Class B1</b>	General Insurance Provision [deleted]
<b>Firms with permission for:</b>	<i>effecting contracts of insurance; and/or</i>
	<i>carrying out contracts of insurance;</i>
	<i>that are general insurance contracts.</i>
<b>Class B2</b>	General Insurance Intermediation
<b>Firms with permission for:</b>	Any of the following in respect of <i>general insurance contracts</i> :
	<i>dealing in investments as agent;</i>
	<i>arranging (bringing about) deals in investments;</i>
	<i>making arrangements with a view to transactions in investments;</i>
	<i>assisting in the administration and performance of a contract of insurance;</i>
	<i>advising on investments;</i>
	<i>agreeing to carry on a regulated activity which is within any of the above.</i>
<b>Tariff base</b>	Class B1: <i>Relevant net premium income</i> and eligible gross technical liabilities. The levy is split into two in the ratio 75:25. The tariff base for the first portion (75%) is calculated by reference to <i>relevant net premium income</i> . The tariff base for the second portion (25%) is based on eligible gross technical

	<p>liabilities.</p> <p>Eligible gross technical liabilities are calculated in accordance with the method for calculating gross technical liabilities in fee block A3 in part 3 of <i>FEES 4 Annex 1BR</i> with the following adjustments.</p> <p>(1) Eligible gross technical liabilities are calculated by reference to <i>protected contracts of insurance with eligible claimants</i>.</p> <p>(2) A <i>firm</i> may choose not to apply paragraph (1) and instead include all gross technical liabilities that it would be obliged to take into account for fee block A3 as long as the amount that it would include under (1) is lower.</p> <p>(3) If an <i>incoming EEA firm</i> does not report gross technical liabilities in the way contemplated by this table, the <i>firm's</i> gross technical liabilities are calculated in the same way as they would be for a <i>UK firm</i>.</p> <p>(4) None of the notes for the calculation of fees in fee block A3 in part 3 of <i>FEES 4 Annex 1BR</i> apply except for the purposes of (2).</p> <p>(5) A <i>directive friendly society</i> must also calculate eligible gross technical liabilities in accordance with this table.</p> <p>(6) A <i>non-directive friendly society</i> must calculate gross technical liabilities as the amount that it is required to show in FSC 2 Form 9 line 11 in Appendix 10 of <i>IPRU(FSOC)</i> (assets allocated towards the general insurance business required minimum margin) in relation to the most recent financial year of the <i>firm</i> (as at the applicable reporting date under <i>FEES 6.5.13R</i>) for which the <i>firm</i> is required to have reported that information to the <i>PRA</i> under <i>IPRU(FSOC)</i>. A <i>non-directive friendly society</i> must disregard for this purpose such amounts as are not required to be included by reason of a <i>waiver</i> or a written concession carried forward as an amendment to the <i>rule</i> to which it relates under SUP TP.</p>
	<p>Class B2: <i>annual eligible income</i> where <i>annual eligible income</i> means annual income adjusted in accordance with this table. Annual income is calculated as the sum of (a) and (b):</p> <p>(a) the net amount retained by the <i>firm</i> of all brokerages, fees, commissions and other related income (for example, administration charges, overrides and profit shares) due to the <i>firm</i> in respect of or in relation to class B2 activities, including any income received from an <i>insurer</i>; and</p> <p>(b) if the <i>firm</i> is an <i>insurer</i>, in relation to class B2 activities, the amount of <i>premiums</i> receivable on its <i>contracts of insurance</i> multiplied by 0.07, excluding those <i>contracts of insurance</i> which result from class B2 activities carried out by another <i>firm</i>, where a payment has been made by the <i>insurer</i> to that other <i>firm</i> and</p>

	<p>that payment is of a type that falls under (a).</p> <p>Notes relating to the calculation of the tariff base for <i>class B2</i>:</p> <p>(1) Exclude annual income for <i>pure protection contracts</i>. Only include <i>general insurance contracts</i>.</p> <p>(2) The calculation is adjusted in accordance with the definition of <i>annual eligible income</i>.</p> <p>(3) Net amount retained means all the commission, fees, etc. in respect of <i>class B2</i> activities that the <i>firm</i> has not rebated to customers or passed on to other <i>firms</i> (for example, where there is a commission chain). Items such as general business expenses (for example, employees' salaries and overheads) must not be deducted.</p> <p>(4) <i>Class B2</i> activities mean activities that fall within <i>class B2</i>. They also include activities that now fall within <i>class B2</i> but that were not <i>regulated activities</i> when they were carried out.</p> <p>(5) A reference to a <i>firm</i> also includes a reference to any <i>person</i> who carried out activities that would now fall into <i>class B2</i> but which were not at the time <i>regulated activities</i>.</p>
	<b>Life and Pensions</b>
<b>Class C1</b>	<del>Life and Pensions Provision</del> [deleted]
<b>Firms with permission for:</b>	<del>effecting contracts of insurance; and/or</del>
	<del>carrying out contracts of insurance;</del>
	<del>that are long term insurance contracts (including pure protection contracts);</del>
<b>Class C2</b>	Life and Pensions Intermediation
<b>Firms with permission for:</b>	Any of the following:
	<i>dealing in investments as agent;</i>
	<i>arranging (bringing about) deals in investments;</i>
	<i>making arrangements with a view to transactions in investments;</i>
	<i>assisting in the administration and performance of a contract of insurance;</i>
	<i>advising on investments;</i>
	<i>advising on pension transfers and pension opt-outs;</i>
<i>providing basic advice on a stakeholder product;</i>	

	<p>agreeing to carry on a regulated activity which is within any of the above;</p> <p>in relation to any of the following:</p> <p><i>long-term insurance contracts (including pure protection contracts);</i></p> <p>rights under a <i>stakeholder pension scheme</i> or a <i>personal pension scheme</i>.</p>
<p><b>Tariff base</b></p>	<p><del>Class C1: Relevant net premium income and eligible mathematical reserves. The levy is split into two in the ratio 75:25. The tariff base for the first portion (75%) is calculated by reference to relevant net premium income. The tariff base for the second portion (25%) is based on mathematical reserves.</del></p> <p><del>Eligible mathematical reserves are calculated in accordance with the method for calculating mathematical reserves in fee block A4 in part 3 of FEES 4 Annex 1BR with the following adjustments:</del></p> <p><del>(1) Eligible mathematical reserves are calculated by reference to protected contracts of insurance with eligible claimants.</del></p> <p><del>(2) A firm may choose not to apply paragraph (1) and instead include all mathematical reserves that it would be obliged to take into account for fee block A4 as long as the amount that it would include under (1) is lower.</del></p> <p><del>(3) If an incoming EEA firm does not report mathematical reserves in the way contemplated by this table, the firm's mathematical reserves are calculated in the same way as they would be for a UK firm.</del></p> <p><del>(4) None of the notes for the calculation of fees in fee block A4 in part 3 of apply except for the purposes of (2).</del></p> <p><del>(5) A directive friendly society must also calculate eligible mathematical reserves in accordance with this table.</del></p> <p><del>(6) A non-directive friendly society must calculate mathematical reserves as the amount that it is required to show in FSC 2–Form 9 line 23 in Appendix 10 of IPRU(FSOC) (total mathematical reserves after distribution of surplus) in relation to the most recent financial year of the firm (as at the applicable reporting date under FEES 6.5.13R) for which the firm is required to have reported that information to the PRA under IPRU(FSOC). A non-directive friendly society must disregard for this purpose such amounts as are not required to be included by reason of a waiver or a written concession carried forward as an amendment to the rule to which it relates under SUP TP.</del></p> <p><del>(7) The provisions relating to pension fund management business in Part 2 of FEES 4 Annex 1BR do not apply. A firm undertaking</del></p>

	<p>such business that does not carry out any other activities within <i>class C1</i> (ignoring any activities that would have a wholly insignificant effect on the calculation of its tariff base for <i>class C1</i>) must use its Long term insurance capital requirement instead of gross technical liabilities. The Long term insurance capital requirement means the amount that it is required to show as its Long term insurance capital requirement in Form 2 Line 31 (Statement of solvency – Long term insurance business) in relation to the most recent financial year of the <i>firm</i> (as at the applicable reporting date under FEES 6.5.13R) for which the firm is required to have reported that information to the PRA.</p> <p>(8) The split in the levy between <i>relevant net premium income</i> and eligible mathematical reserves does not apply to a partnership pension society (as defined in Chapter 7 of IPRU(FSOC) (Definitions)). Instead the levy is only calculated by reference to <i>relevant net premium income</i>.</p>
	<p>Class C2: <i>annual eligible income</i> where <i>annual eligible income</i> means annual income adjusted in accordance with this table. Annual income is calculated as the sum of (a) and (b):</p> <p>(a) the net amount retained by the <i>firm</i> of all brokerages, fees, commissions and other related income (for example, administration charges, overrides and profit shares) due to the <i>firm</i> in respect of or in relation to <i>class C2</i> activities including any income received from an <i>insurer</i>; and</p> <p>(b) if the <i>firm</i> is a life and pensions <i>firm</i>, in relation to <i>class C2</i> activities, the amount of <i>premiums</i> or commission receivable on its life and pensions contracts multiplied by 0.07, excluding those life and pensions contracts which result from <i>class C2</i> activities carried out by another <i>firm</i>, where a payment has been made by the life and pensions <i>firm</i> to that other <i>firm</i> and that payment is of a type that falls under (a).</p> <p>Notes relating to the calculation of the tariff base for <i>class C2</i>:</p> <p>(1) Life and pensions contracts mean <i>long-term insurance contracts</i> (including <i>pure protection contracts</i>) and rights under a <i>stakeholder pension scheme</i> or a <i>personal pension scheme</i>.</p> <p>(2) Life and pensions <i>firm</i> means an <i>insurer</i>. It also means a <i>firm</i> that provides <i>stakeholder pension schemes</i> or <i>personal pension schemes</i> if those activities fall into <i>class D1</i>.</p> <p>(3) The calculation is adjusted in accordance with the definition of <i>annual eligible income</i>.</p> <p>(4) Net amount retained means all the commission, fees, etc. in respect of <i>class C2</i> activities that the <i>firm</i> has not rebated to customers or passed on to other <i>firms</i> (for example, where there is a commission chain). Items such as general business expenses (for example, employees' salaries and overheads) must not be</p>

	deducted.  (5) <i>Class C2</i> activities mean activities that fall within <i>class C2</i> . They also include activities that now fall within <i>class C2</i> but that were not <i>regulated activities</i> when they were carried out.  (6) A reference to a <i>firm</i> also includes a reference to any <i>person</i> who carried out activities that would now fall into <i>class C2</i> but which were not at the time <i>regulated activities</i> .
	<b>Investment</b>
...	
<b>Class D2</b>	Investment <u>and Structured Deposits</u> intermediation
<b>Firms with permission for:</b>	<i>intermediation of structured deposits (except for managing investments in relation to structured deposits)</i>  Any of the following in relation to <i>designated investment business</i> :  <i>dealing in investments as principal;</i>  <i>dealing in investments as agent;</i>  <i>MiFID business bidding;</i>  <i>arranging (bringing about) deals in investments;</i>  <i>making arrangements with a view to transactions in investments;</i>  <i>advising on investments;</i>  <i>providing basic advice on a stakeholder product;</i>  <i>safeguarding and administering investments;</i>  <i>arranging safeguarding and administering of assets;</i>  <i>operating a multilateral trading facility;</i>  <i>agreeing to carry on a regulated activity which is within any of the above;</i>  BUT excluding activities that relate to <i>long-term insurance contracts</i> or rights under a <i>stakeholder pension scheme</i> or a <i>personal pension scheme</i> .
<b>Tariff base</b>	Class D1: <i>annual eligible income</i> where <i>annual eligible income</i> means annual income adjusted in accordance with this table. Annual income is equal to the net amount retained by the <i>firm</i> of all income due to the <i>firm</i> in respect of or in relation to activities

	<p>falling within <i>class D1</i>.</p> <p>Class D2 <u>except in respect of <i>direct sales of structured deposits</i>: <i>annual eligible income</i> where <i>annual eligible income</i> means annual income adjusted in accordance with this table. Annual income is equal to the net amount retained by the <i>firm</i> of all income due to the <i>firm</i> in respect of or in relation to activities falling within <i>class D2</i>.</u></p> <p>Notes on <i>annual eligible income</i> for <i>classes D1</i> and <i>D2</i> (<u>except in respect of <i>direct sales of structured deposits</i></u>):</p> <p>(1) For the purposes of calculating annual income, net amount retained means all the commission, fees, etc. in respect of activities falling within <i>class D1</i> or <i>D2</i>, as the case may be, that the <i>firm</i> has not rebated to customers or passed on to other <i>firms</i> (for example, where there is a commission chain). Items such as general business expenses (for example employees' salaries and overheads) must not be deducted.</p> <p>(2) The calculation is adjusted in accordance with the definition of <i>annual eligible income</i>.</p> <p>(3) Box management profits are excluded from the calculation of annual income.</p> <p><u>Class D2 in respect of <i>direct sales of structured deposits</i>: the tariff base in respect of <i>direct sales of structured deposits</i> is the tariff base for Class A (DGS members) set out in the Depositor Protection part of the <i>PRA Rulebook</i>, but <u>only to the extent that it relates to deposits that are <i>structured deposits</i>, multiplied by 0.07.</u></u></p>
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	Home Finance
<b>Class E2</b>	Home Finance Intermediation
<b>Firms with permission for:</b>	Any of the following activities:
	<i>arranging (bringing about) a home finance transaction;</i>
	<i>making arrangements with a view to a home finance transaction;</i>
	<i>advising on home finance transaction;</i>
	the activities of a <i>home finance provider</i> which would be arranging but for article 28A of the <i>Regulated Activities Order</i> (Arranging contracts or plans to which the arranger is a party);
	<i>agreeing to carry on a regulated activity which is within any of the above.</i>

<b>Tariff base</b>	Class: E2: annual <i>eligible income</i> where the annual income is calculated in accordance with the fee-block A18 in part 2 of <i>FEES 4 Annex 1AR</i> .
<b>Class F</b>	<b>Deposit acceptor's contribution</b>
<b>Firms with permission for:</b>	<i>accepting deposits and/or operating a dormant account fund. BUT does not include any fee payer who either effects or carries out contracts of insurance.</i>
<b><u>Tariff base</u></b>	<u>The tariff base for Class A (DGS members) in the Depositor Protection part of the <i>PRA's Rulebook</i>.</u>
<b>Class G</b>	<b>Insurers – life contribution</b>
<b>Firms with permission for:</b>	<i>effecting contracts of insurance; and/or</i>
	<i>carrying out contracts of insurance;</i>
	<u>in respect of specified investments including <i>life policies</i> that are long term insurance contracts (including pure protection contracts);</u>
	<i>entering as provider into a funeral plan contract.</i>
<b><u>Also applies to:</u></b>	<u>the <i>Society</i>.</u>
<b><u>Tariff base</u></b>	<p>For the <i>Society</i>, the aggregate of the tariff base for Insurance Class C1 in the Policyholder Protection part of the <i>PRA Rulebook</i> that would apply to each <i>member</i> if:</p> <p>(a) that tariff base applied to each <i>member</i> in respect of his <i>insurance business</i> in relation to <i>long-term insurance contracts (including pure protection contracts)</i>; and</p> <p>(b) all references to “firm” or “participant firm” in the Policyholder Protection part of the <i>PRA Rulebook</i> were read as referring to the <i>member</i>.</p> <p><u>For all other <i>participant firms</i>, the tariff base for Insurance Class C1 in the Policyholder Protection part of the <i>PRA Rulebook</i>.</u></p>
<b>Class H</b>	<b>Insurers – general contribution</b>
<b>Firms with permission for:</b>	<i>effecting contracts of insurance; and/or</i>
	<i>carrying out contracts of insurance;</i>
	<i>in respect of <del>specified investments</del> that are:</i> = <i>general insurance contracts</i> ; <del>or</del>

	<del>—long term insurance contracts other than life policies.</del>
<b><u>Also applies to:</u></b>	<u>the Society.</u>
<b><u>Tariff base</u></b>	<p>For the <i>Society</i>, the aggregate of the tariff base for Insurance Class B1 in the Policyholder Protection part of the <i>PRA Rulebook</i> that would apply to each <i>member</i> if:</p> <p>(a) that tariff base applied to each <i>member</i> in respect of his <i>insurance business</i> in relation to <i>general insurance contracts</i>; and</p> <p>(b) all references to “firm” or “participant firm” in the Policyholder Protection part of the <i>PRA Rulebook</i> were read as referring to the <i>member</i>.</p> <p>For all other <i>participant firms</i>, the tariff base for Insurance Class B1 in the Policyholder Protection part of the <i>PRA Rulebook</i>.</p>
<b>Class I</b>	<b>Home finance provision</b>
<b>Firms with permission for:</b>	Any of the activities below:
	<i>entering into a home finance transaction;</i>
	<i>administering a home finance transaction;</i>
	<i>agreeing to carry on a regulated activity which is within any of the above.</i>
<b><u>Tariff base</u></b>	<u>The number of home finance transactions, calculated in accordance with the tariff base for fee-block A2 in part 2 of FEES 4 Annex 1AR.</u>
<b>Class K</b>	<b><u>Debt management claims</u></b>
<b><u>Firms with permission for:</u></b>	<u>Any of the following:</u>
	<i>debt adjusting and/or debt counselling in relation to protected debt management business except where these activities are carried on by a not-for-profit debt advice body;</i>
	<i>entering into a regulated credit agreement as lender;</i>
	<i>exercising, or having the right to exercise, the lender’s rights and duties under a regulated credit agreement.</i>
<b><u>Tariff base</u></b>	<p>For debt adjusting and debt counselling: annual debts under management being the annual total value of the <i>participant firm’s relevant debts under management</i>.</p> <p>For all other <i>participant firms</i> in this class; annual lending being the annual total amount provided under all <i>regulated credit</i></p>

	<u>agreements in respect of which the <i>participant firm</i> is the <i>lender</i> or exercises, or has the right to exercise, the <i>lender's</i> rights and duties under such agreements.</u>
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<b>Notes <u>for all classes</u></b>	
...	
<p>(3) The question of whether a <i>person</i> is an <i>eligible claimant</i> or not <del>or whether a <i>contract of insurance</i> is a <i>protected contract</i> or not</del> or whether business is compensatable business or not must be judged at whichever of the following dates the <i>firm</i> chooses:</p> <p>...</p> <p><del>However this does not apply for the purpose of calculating the tariff base for <i>class A (Deposits)</i> so far as it relates to <i>protected deposits</i>.</del></p>	
<p>(4) For classes G to I (inclusive) the tariff base is not set out in this Annex: see <i>FEES 6.4.7R(3)</i>, <i>FEES 6.5.6R(3)</i> and <i>FEES 6.5A.6R</i></p>	

**6 Annex 4G Guidance on the calculation of tariff bases**

This table belongs to *FEES 6.5.8G*

Calculation of annual eligible income for firms in class D1 who carry out discretionary fund management and are in FCA fee block A7		
-1.1 {FCA}	G	The tariff base for <i>class D1</i> is calculated by taking gross income falling into <i>class D1</i> and then deducting commission, fees and similar amounts rebated to customers or passed on to other <i>firms</i> (for example, where there is a commission chain). Items such as general business expenses (for example employees' salaries and overheads) should not be deducted. The calculation <del>should</del> <u>may</u> be further adjusted so as to <del>exclude</del> <u>include only</u> income that is <del>not</del> attributable to business <del>conducted with or for the benefit of <i>eligible claimants</i> in respect of which the FSCS may pay compensation,</del> unless the <i>firm</i> chooses to include <del>such</del> <u>all its annual</u> income.
1.1 {FCA}	G	Gross income for the activity of <i>managing investments</i> is the sum of the following:
		(1) the amount of the annual charge on all assets in portfolios which the <i>firm</i> manages on a discretionary basis received or receivable in the latest accounting period (this is calculated as a percentage of funds invested, typically 1% p.a.); plus

		(2)	the front-end or exit charge levied on sales or redemptions of assets in portfolios which the <i>firm</i> manages on a discretionary basis (typically 4-5% of sales/redemptions) in that same accounting period; plus
		(3)	the amount of performance management fees from the management of assets in portfolios which the <i>firm</i> manages on a discretionary basis received or receivable in that same accounting period; plus
		(4)	any other income directly attributable to the management of assets in portfolios which the <i>firm</i> manages on a discretionary basis in that same accounting period, including commission and interest received.
1.2 {FCA}	G	<i>Annual eligible income</i> should exclude	
		income received or receivable from assets managed on a non-discretionary basis, being assets that the <i>firm</i> has a contractual duty to keep under continuous review but in respect of which prior specific consent of the client must be obtained for proposed transactions, as this activity is covered in <i>class D2</i> (the investment and structured deposits intermediation <i>class</i> ).	
1.3 {FCA}	G	A <i>firm</i> should make appropriate arrangements to ensure that income is not double counted in relation to the activities it undertakes (for example, where it operates and manages a <i>personal pension scheme</i> or <i>collective investment scheme</i> ).	
<b>Calculation of annual eligible income for firms in sub-class D1 and who carry out activities within FCA FCA fee block A9</b>			
2.1 {FCA}	G	The calculation of income in respect of activities falling into <i>class D1</i> and <i>FCA</i> fee block A9 should be based on the tariff base provisions for that fee block (in Part 3 of <i>FEES 4 Annex 1AR</i> ). It <del>should</del> <u>may</u> be adjusted so as to <del>exclude</del> <u>include only</u> income that is <del>not</del> attributable to business <del>conducted with or for the benefit of</del> <u>eligible claimants</u> in respect of which the <i>FSCS</i> may pay <u>compensation</u> , unless the <i>firm</i> chooses to include <del>such</del> <u>all its</u> <u>annual</u> income.	
2.2 {FCA}	G	Although the calculation should be based on the one for fee block A9, the calculation is not the same. <i>FCA</i> fee block A9 is based on gross income. <i>Class D1</i> is based on net income retained.	
<b>Calculation of annual eligible income for a firm in class B2 or class C2</b>			
3.1 {FCA}	G	The amount of <i>annual eligible income</i> should include the amount of any trail or renewable commission due to the <i>firm</i> . Trail commission is received as a small percentage of the value of a policy on an ongoing basis. Renewable commission is received	

		from a very small percentage of the value of a policy from ongoing premiums often received once the initial commission period is over.
<b>Difficulties in calculating annual eligible income</b>		
4.1 {FCA}	G	The purpose of Note 2 in the section of notes at the end of <del>FEES</del> <i>FEES</i> 6 Annex <del>3R</del> <i>3AR</i> (Financial Services Compensation Scheme - classes) is to deal with the practical difficulties of allocating income correctly between different <i>classes</i> and in deciding whether income falls outside <del>FEES</del> <i>FEES</i> 6 Annex <del>3R</del> <i>3AR</i> altogether. Note 2 requires a <i>firm</i> to carry out the necessary apportionment on a reasonable and consistent basis.
4.2 {FCA}	G	The following provides some <i>guidance</i> as to how <i>firms</i> may approach the allocation of <i>annual eligible income</i> .
4.3 {FCA}	G	Where a <i>firm</i> cannot separate its income on the basis of activities, such as a fund manager which acts on a discretionary and non-discretionary basis for the same <i>client</i> and who only sends out a single invoice, the <i>firm</i> may apportion the income in another way. For instance, a <i>firm</i> may calculate that the business it undertook for a <i>client</i> was split 90% on a discretionary basis and 10% on a non-discretionary basis calculated by reference to funds under management. The <i>firm</i> may split the income accordingly.
4.4 {FCA}	G	A <i>firm</i> may allocate trail or renewable commission on the basis of the type of <i>firm</i> it receives it from. For instance, if it comes from a life provider the <i>firm</i> may consider it as life and pensions mediation income. If it comes from a fund manager the <i>firm</i> may treat it as investment mediation income.
4.5 {FCA}	G	If a <i>firm</i> receives <i>annual eligible income</i> from a platform based business it may report <i>annual eligible income</i> in line with the proportionate split of business that the <i>firm</i> otherwise undertakes. For instance, if a <i>firm</i> receives 70% of its other commission from life and pensions mediation business and 30% from investment mediation business, then it may divide what it receives in relation to the platform business on the same basis.
4.5A	G	<i>Firms</i> should have regard to the ability of the <i>FSCS</i> to pay <u>compensation to members of pension schemes and to <i>participants in collective investment schemes</i> (see <i>COMP 12A</i> (Special cases)) when calculating their <i>annual eligible income</i>.</u>
4.6 {FCA}	G	Unless a <i>firm</i> chooses to include all relevant annual income, <i>annual eligible income</i> excludes business that is not compensatable under the <i>compensation scheme</i> . This can create difficulties because, for example, a <i>person</i> may move between being and not being an <i>eligible claimant</i> over time. The purpose of

		Note 3 in the section of notes at the end of <i>FEES 6 Annex 3R 3AR</i> is to deal with that difficulty by fixing a date for deciding this.
<b>Gross technical liabilities and mathematical reserves for non-directive friendly societies</b>		
5.1 [PRA]	G	The tariff base for a <i>non-directive friendly society</i> carrying out general insurance business is based in part on gross technical liabilities and the tariff base for a <i>non-directive friendly society</i> carrying out life insurance business is based in part on mathematical reserves. These concepts do not directly apply to <i>non-directive friendly societies</i> and so the tariff base calculation uses a corresponding concept.
5.2 [PRA]	G	The figures for gross technical liabilities and mathematical reserves of a <i>non-directive friendly society</i> for the purpose of calculating its tariff base in class B1 (General Insurance Provision) and C1 (Life and Pensions Provision) are based on a valuation. This valuation only has to be made every three years. <i>FEES 6</i> does not require a <i>non-directive friendly society</i> to update that information every year. Instead the figures from a <i>non-directive friendly society's</i> valuation will be used on a rolling three year basis for the purposes of the levy calculations in <i>FEES 6</i> . The effect of this calculation is therefore to modify the normal basis on which information is supplied under <i>FEES 6.5.13R</i> .

## 6 Annex 5R Classes participating in the retail pool and applicable limits

This table belongs to *FEES 6.5A.1R*.

Class	Attributable costs for this class in excess of levy limit allocated to the retail pool?	Retail pool levy limit (£ million)	Retail pool compensation costs levy or specific costs levy allocated to this class?
<b>FCA provider contribution classes</b>			
[Note: The <i>FCA provider contribution classes</i> contribute to a <i>compensation costs levy</i> or <i>specific costs levy</i> allocated to the <i>retail pool</i> , unless the <i>compensation costs</i> or <i>specific costs</i> are attributable to the investment provision class. <del><i>Compensation costs</i> or <i>specific costs</i> attributable to the corresponding <i>PRA funding classes</i> are never allocated to the <i>retail pool</i></del> ]			
...			
<b>Classes that both contribute to and are funded by the retail pool</b>			
[ <del>Note</del> <u>Note</u> : ...]			

...	Yes, under <i>FEES 6.5.2AR(2) 6.5.2-AR(2)</i> (but costs attributable to the investment provision <i>class</i> cannot be allocated to the <i>FCA provider contribution classes</i> )	...	...
...			
...			
...			
...			
<u>Debt management claims</u>			

...

**TP 2 Transitional provisions relating to changes to the FSCS levy arrangements taking effect in 2007/8 and in 2008/9**

...		
<b>2.4</b>	<b>Allocation of recoveries</b>	
2.4.1 <del>[FCA]</del> <del>[PRA]</del>	R	Any recoveries made by the <i>FSCS</i> after 31 March 2008 in relation to <i>protected claims</i> compensated prior to 1 April 2008, the costs of which were allocated to the relevant contribution group in place at the time, must be credited to the <i>sub-class</i> in place after 31 March 2008 to which the costs of the <i>protected claim</i> would have been allocated had it been compensated after that date, or if relevant, in accordance with <i>FEES 6.3.20R</i> .
2.4.2 <del>[FCA]</del> <del>[PRA]</del>	R	<i>FEES TP 2.4.1R</i> does not apply to the extent that it is inconsistent with the <i>compensation transitionals order</i> .
<b>2.5</b>	<b>Interpretation</b>	
2.5.1 <del>[FCA]</del> <del>[PRA]</del>	R	In <i>FEES TP 2</i> ‘contribution group’ means one of the groups of participant firms within a sub-scheme in existence prior to 1 April 2008 set out in <i>FEES 6.5.7R</i> at the time, being groups that carried on business of a similar nature, to which <i>compensation costs</i> and <i>specific costs</i> were allocated in accordance with <i>FEES 6.4</i> and <i>FEES 6.5</i> in force at the time. Sub-scheme means one of the sub-schemes to which <i>FSCS</i> allocated liabilities for <i>compensation costs</i> prior to 1 April 2008, as described in <i>FEES 6.5.7R</i> at the time.

2.5.2 [FCA] [PRA]	R	For the purpose of <i>FEES</i> 6.5.13R as it applies with respect to the <del><i>FSCS's financial year</i></del> <i>financial year of the compensation scheme</i> beginning on 1 April 2008:
	(1)	references in <i>FEES</i> 6.5.13R to <i>sub-classes</i> must be read as references to <i>sub-classes</i> to which <i>firms</i> will belong after 31 March 2008; and
	(2)	(where <i>FEES</i> TP provides for the tariff base for a <i>sub-class</i> to be calculated by reference to a contribution group prior to that date) <i>FEES</i> 6.5.13R(1) must be read as also including a requirement for the supply of the necessary information in relation to that contribution group.
2.5.3 [FCA] [PRA]	R	The amendments made to <i>FEES</i> 6.5.16R by the Fees Manual (FSCS Funding) Instrument 2007 only have effect before 1 April 2008 for the purpose of <del><i>FSCS's financial year</i></del> <i>the financial year of the compensation scheme</i> beginning on 1 April 2008.
2.5.4 [FCA] [PRA]	G	<i>FEES</i> 6 Annex 2R and <i>FEES</i> 6 Annex 3R ( <i>classes, sub-classes</i> and tariff bases) are brought into force for the purpose of <i>FEES</i> TP and <i>FEES</i> 6.5.13R in November 2007. However they do not have any other effect until 1 April 2008.
<b>2.6</b>	<b>Past defaults</b>	
2.6.1 [FCA] [PRA]	G	<p>The changes made to the <i>levy rules</i> made by the Fees Manual (FSCS Funding) Instrument 2007 apply to any levy made after 31 March 2008. This is so even if:</p> <p>(1) the claim against the <i>firm in default</i> arose or relates to circumstances arising before that date; <u>or</u></p> <p>(2) the <i>firm</i> was <i>in default</i> before that date; <del>or</del> <u>or</u></p> <p>(3) <del>the levy relates to arrangements or measures under <i>COMP</i> 3.3 made or taken before that date.</del> [deleted]</p>
...		

**TP 7 Transitional provisions relating to changes to the FSCS levy arrangements taking effect in 2013/14**

7.1 [FCA] [PRA]	R	As at 31 March 2013, the <i>FSCS</i> must:	
		(1)	allocate any surplus or deficit in the balance of an <i>FSA</i> activity group in respect of <i>base costs</i> , to the account of the corresponding <i>FCA</i> activity group as listed in <i>FEES 4 Annex 1AR</i> as at 1 April 2013; and
		(2)	take that surplus or deficit (so allocated) into account when calculating the amount to be levied under <i>FEES 6.4.5R</i> in respect of the <del>financial year</del> <i>financial year of the compensation scheme</i> commencing on 1 April 2013.
7.2 [FCA]	R	For the purpose of <i>FEES 6.5A.6R</i> , ‘ <i>FEES 4 Annex 1AR</i> ’ must be read as ‘ <i>FEES 4 Annex 1R</i> ’ (as it was in force immediately before 1 April 2013) until the <i>regulatory costs</i> arising from the activity group in <i>FEES 4 Annex 1AR</i> have been determined. The <i>FSCS</i> may recalculate the liabilities once the <i>regulatory costs</i> arising from the activity group in <i>FEES 4 Annex 1AR</i> have been determined and credit or debit <i>participant firms</i> as appropriate.	

Insert the new TP 15 after FEES TP 14 (Transitional provisions relating to statements provided by participant firms before 1 April 2018 with respect to the FSCS 2018/19 financial year). All the text is new and is not underlined.

**TP 15 Transitional provisions relating to changes to the FSCS levy arrangements taking effect in 2018/19**

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook Provisions coming into force
15	The changes made to <i>FEES 6</i> by the FSCS Funding and Scope Instrument 2017	R	The changes in (2) apply to any levy made after 31 March 2018. This is so even if:  (1) the claim against the <i>relevant person</i> or <i>successor in default</i> arose or relates to circumstances arising before that date; or  (2) the <i>relevant person</i> or <i>successor</i> was <i>in default</i>	From 1 April 2018 indefinitely	1 April 2018

			before that date.		
--	--	--	-------------------	--	--

## Annex D

## Amendments to the Supervision manual (SUP)

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

13A Application of the Handbook to Incoming EEA Firms  
Annex 1G

...

1) Module of Handbook	(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom	(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom
...		
COMP	<p>Applies, except in relation to the <i>passported activities</i> of a <i>MiFID investment firm</i>, <del>a <i>CRD credit institution</i> (other than an electronic money institution within the meaning of article 1(3)(a) of the <i>E-Money Directive</i> that has the right to benefit from the mutual recognition arrangements under the <i>CRD</i>)</del>, an <i>IMD insurance intermediary</i>, a <i>UCITS management company</i> carrying on non-core services under article 6.3 of the <i>UCITS Directive</i>, an <i>MCD mortgage credit intermediary</i> and an incoming <i>AIFM branch</i> carrying on either <i>AIFM management functions</i> for an <i>unauthorised AIF</i> or non-core services under article 6.4 of <i>AIFMD</i> (see the definition of "<i>participant firm</i>"). However, a <i>firm</i> specified above may be able to apply for <i>top-up cover</i> in relation to its <i>passported activities</i> (see <i>COMP 14</i> (Participation by EEA Firms)).</p>	<p>Does not apply in relation to the <del>passported activities</del> <u><i>passported activities</i></u> of an <del>a</del> <u><i>MiFID investment firm</i></u>, a <del><i>CRD credit institution</i></del>, an <i>IMD insurance intermediary</i>, an <i>MCD mortgage credit intermediary</i> or a <i>UCITS management company</i> carrying on non-core services under article 6.3 of the <i>UCITS Directive</i> or an incoming <i>EEA AIFM</i> regarding <i>AIFM management functions</i> carried on for an <i>unauthorised AIF</i> or non-core services under article 6.4. <u>Applies in relation to the <i>passported activities</i> of a <i>UCITS management company</i> in relation to the management of a <i>UCITS scheme</i> and of an <i>AIFM</i> in relation to the management of an <i>authorised AIF</i>.</u></p>

		Otherwise, <i>COMP</i> may apply, but the coverage of the <i>compensation scheme</i> is limited for non-UK activities (see <i>COMP</i> 5).
...		

SUP 16 Annex 18AR (Section J: Data Required for Calculation of Fees) is deleted and replaced with the text shown in the following page. The deleted text is not shown and the new text is not shown underlined.

**Section J: data required for the calculation of fees**

## Part 1

		A	B	C
		FCA	FOS	FSCS
		Annual Regulated Income	Relevant Annual Income	Annual Eligible Income
<b>1</b>	Home Finance Intermediation	FEES 4 Annex 1AR Part 3, fee block A.18	FEES 5 Annex 1R, industry block 16	FEES 6 Annex 3AR Class E2
<b>2</b>	General Insurance Intermediation	FEES 4 Annex 1AR Part 3, fee block A.19	FEES 5 Annex 1R, industry block 17	FEES 6 Annex 3AR Class B2
<b>3</b>	Life and Pensions Intermediation	FEES 4 Annex 1AR Part 3, fee block A.13	Annual income as applied in relation to the equivalent activity groups set out in Part 1 of FEES 4 Annex 1R in respect on industry blocks 8 and 9	FEES 6 Annex 3AR Class C2
<b>4</b>	Investment and Structured Deposits Intermediation	FEES 4 Annex 1AR, Part 3, fee block A.13	Annual income as applied in relation the equivalent activity groups set out in Part 1 of FEES 4 Annex 1R in respect of industry blocks 8 and 9	FEES 6 Annex 3AR Class D2

## Part 2

Firms with the following permissions listed below are required to answer questions 5 and 6.

- *Arranging (bringing about) deals in investments*
- *Making arrangements with a view to transactions in investments*
- *Advising on investments*
- *Advising on pension transfers and pension opt-outs*

**5. Do you offer, recommend or sell any of the following investments?**

- (1) non-mainstream pooled investments,
- (2) non-readily realisable securities,
- (3) contingent convertible instruments,
- (4) CoCo funds, or
- (5) mutual society shares.

**6. If the answer to question 5 is yes, please state the amount of your *annual eligible income* reported in 3C or 4C in Part 1 derives from the business listed in question 5.**

16  
Annex  
18BG

Notes for Completion of the Retail Mediation Activities Return ('RMAR')

...

**Section J: Data required for calculation of fees**

Part 1

...

This information is required so that we can calculate the fees payable by *firms* in respect of the *FCA*, *FOS* and the *FSCS*.

<b>Data for fees calculations</b>	<i>Firms</i> will need to report data for the purpose of calculating <i>FCA</i> , <i>FOS</i> and <i>FSCS</i> levies
...	...
FSCS	The relevant information required is the tariff data set out in classes B2, C2, D2 and E2, <i>FEES 6 Annex 3R 3AR</i> . Note that <i>firms</i> are required to report tariff data information relating to all business falling within classes B2, C2, D2 and E2, <i>FEES 6 Annex 3R 3AR</i> .

*Personal investment firms* and *firms* whose regulated activities are limited to one or more of: *insurance mediation activity*, *home finance mediation activity*, or *retail investment activity*, are required to complete Part 1, section J of the *RMAR*.

Part 2

Only *firms* whose regulated activities include one or more of:

- *arranging (bringing about) deals in investments,*
- *making arrangements with a view to transactions in investments,*
- *advising on investments or*
- *advising on pension transfers and pension opt-outs,*

are required to complete Part 2, section J of the *RMAR*. This information is required to enable the *FCA* to monitor the distribution of certain specified products and to inform the development of proposals to consider introducing a risk-based *FSCS* levy in the future.

*Firms* required to complete Part 2, section J of the *RMAR* must declare whether they offer, recommend or sell any of:

- *non-mainstream pooled investments,*
- *non-readily realisable securities,*
- *contingent convertible investments,*
- *CoCo funds or*

- mutual society shares,

and, if so, how much of the annual eligible income reported under Part 1, section J of the *RMAR* derives from such activity.

Both Parts 1 and 2

*Firms* which do not yet have data for a full 12 ~~months~~ months ending on their *accounting reference date* (for example if they have not traded for a complete ~~financial year~~ financial year by the time of the *accounting reference date*) should complete Section J with an ‘annualised’ figure based on the actual income up to their *accounting reference date*. That is, such *firms* should pro-rate the actual figure as if the *firm* had been trading for 12 ~~months~~ months up to the *accounting reference date*. So for a *firm* with 2 ~~months~~ months of actual income of £5000 as at its *accounting reference date*, the ‘annualised’ figure that the *firm* should report is £30,000.

...

	<b>FCA</b> Annual Regulated Income (£s)	<b>FOS</b> Relevant Annual Income (£s)	<b>FSCS</b> <u>Annual Eligible Income</u> (£s)
Home finance <del>Mediation</del> <u>intermediation</u>	<i>FEES</i> 4 Annex 11AR, 13G	<i>FEES</i> 5 Annex 1R industry block 16	<u><i>FEES</i> 6 Annex 3AR</u> class E2
<del>Non-</del> investment General Insurance <del>mediation</del> <u>intermediation</u>	<i>FEES</i> 4 Annex 11AR, 13G	<i>FEES</i> 5 Annex 1R industry block 17	<u><i>FEES</i> 6 Annex 3AR</u> class B2
Life and pensions <del>mediation</del> <u>intermediation</u>	<i>FEES</i> 4 Annex 11AR, 13G	<i>FEES</i> 5 Annex 1R industry block 8, 9	<u><i>FEES</i> 6 Annex 3AR</u> class C2
Investment and Structured Deposits <del>mediation</del> <u>intermediation</u>	<i>FEES</i> 4 Annex 11AR, 13G	<i>FEES</i> 5 Annex 1R industry block 8, 9	<u><i>FEES</i> 6 Annex 3AR</u> class D2

## Annex E

### Amendments to the Compensation sourcebook (COMP)

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

#### INTRO 1A Foreword

**(This Foreword to the Compensation sourcebook does not form part of COMP.)**

The *Act* requires the *FCA* and the *PRA* to make rules establishing a scheme for compensating consumers in cases where: (i) ~~authorised firms~~ relevant persons are unable, or likely to be unable, to satisfy claims against them; or (ii) persons who have assumed responsibility for liabilities arising from acts or omissions of authorised *firms* ("successors") are unable, or likely to be unable, to satisfy claims against the successors that are based on those acts or omissions. The body established to operate and administer the compensation scheme is the *Financial Services Compensation Scheme Limited (FSCS)*. The *PRA*'s compensation rules deal with claims for deposits and under contracts of insurance and the *FCA*'s compensation rules deal with other types of claim.

By making rules that allow the *FSCS* to pay compensation to retail consumers and small businesses, and focusing protection on those who need it most, the compensation scheme rules form an important part of the toolkit the *FCA* will use to meet its statutory objectives. ...

COMP INTRO 1B (Foreword) is deleted in its entirety. The deleted text is not shown.

#### 1.1 Application, Introduction, and Purpose

...

##### Introduction

...

- 1.1.6 G The ~~appropriate regulator is~~ *FCA* and *PRA* are also required, under section 213 of the *Act* (The compensation scheme), to make *rules* establishing a compensation scheme. ~~These~~ The *FCA*'s rules are set out in the remaining chapters of this sourcebook, and are directed to the *FSCS*, claimants and potential claimants, and *firms*. The *PRA*'s rules, which deal with claims for deposits and under contracts of insurance, may be found at [www.prarulebook.co.uk](http://www.prarulebook.co.uk).

...

1.1.8 G *COMP* 1 consists of *guidance* which is aimed at giving an overview of how this sourcebook works. The provisions of *COMP* 2 to *COMP* 47 ~~14~~ cover who is eligible, the amount of compensation and how it might be paid; ~~disclosure requirements for firms that accept deposits and systems and information requirements for firms that accept deposits.~~

...

**1.3 Claimants**

1.3.1 G The *FSCS* also provides information to claimants and potential claimants ...

...

1.3.3 G **Areas of particular interest to claimants (see *COMP* 1.1.3G)**

This Table belongs to *COMP* 1.1.3G.

<b>Q1</b>	<b>What do I need to do in order to receive compensation?</b>		
<b>A1</b>	In order to receive compensation:		
	(-1)	<u>If your claim is for a deposit or under a contract of insurance, see the <i>PRA</i>'s Depositor Protection or Policyholder Protection rules;</u>	
	(1)		
	...		
...			

...

*COMP* 1.4 (EEA Firms) is deleted in its entirety. The deleted text is not shown.

**1.5 Application to Lloyd's**

Levies on the Society of Lloyd's

1.5.5 D The following *core provisions* of the *Act* apply to the carrying on of *insurance market activities by members*:

- (1) Part 9A (Rules and guidance) for the purpose of applying the *rules* in *COMP* and relevant interpretative provisions;
- (2) Part XV (Financial Services Compensation Scheme).

[**Note:** section 316 of the Act]

- 1.5.5A G The insurance market direction in COMP 1.5.5D is intended to advance the FCA's consumer protection objective in section 1C of the Act by assisting the FSCS to impose a levy on the Society, calculated as the aggregate of the levies that would be imposed on members, in accordance with FEES 6.3.24R. As a result of section 317(2) of the Act, references to an authorised person in Part XV of the Act include a member.

...

## 2 The FSCS

...

### 2.2 Duties of the FSCS

...

#### Informing the FSCS

- 2.2.9 G The ~~appropriate regulator~~ FCA will inform the FSCS if it detects problems in a firm that is likely to give rise to the intervention of the FSCS.

[**Note:** article 10(1), part of last sub-paragraph of the *Deposit Guarantee Directive*]

#### Systems

- 2.2.10 R [**Note:** article 10(1), part of last sub-paragraph of the *Deposit Guarantee Directive*] ~~[deleted]~~

...

## 3 The qualifying conditions for compensation

...

### 3.1 Application and Purpose

...

#### Purpose

- 3.1.3 G The purpose of this chapter is to set out in general terms the conditions that must be satisfied before the FSCS can make an offer of compensation, ~~or secure continuity of insurance cover, or provide assistance to an insurance undertaking to enable it to continue insurance business.~~

...

### 3.2 The qualifying conditions for paying compensation

3.2.1 R The *FSCS* may pay compensation to an *eligible claimant*, subject to *COMP* 11 (Payment of compensation) if it is satisfied that:

- (1) an *eligible claimant* has made an application for *compensation* (~~but see *COMP* 3.2.1AR~~ or the *FSCS* is treating the *person* as having done so);

...

...

Claims on behalf of another person

...

3.2.3 G Examples of the circumstances covered by *COMP* 3.2.3R are:

- (1) ...
- (2) when trustees make a *claim* on behalf of beneficiaries (for further provisions relating to *claims* by trustees, see ~~*COMP* 12.6.1R to *COMP* 12.6.7R~~ 12A.1.1R to 12A.1.7R);

...

...

Special cases

3.2.5 G See *COMP* 12A (Special cases) for how the *FSCS* may pay compensation in certain cases.

*COMP* 3.3 (Insurance) is deleted in its entirety. The deleted text is not shown.

## **4 Eligible claimants**

...

### **4.2 Who is eligible to benefit from the protection provided by the FSCS?**

4.2.1 R ~~Unless *COMP* 4.2.3R applies, an~~ An *eligible claimant* is any *person* who at any material time:

...

Persons not eligible to claim unless *COMP* 4.3 applies (see *COMP* 4.2.1R)

4.2.2 R This table belongs to *COMP* 4.2.1R

...			
(9)	<i>Bodies corporate in the same group as the relevant person in default or, in respect of a claim against a successor in default, bodies corporate in the same <del>group</del> group as a successor or the relevant person, as applicable, unless that body corporate is:</i>		
	...		
	(aa)	<del>(if the claim is with respect to a long-term insurance contract) a trustee of; an occupational pension scheme; or</del>	
	(ab)	<del>(if the claim is not with respect to a long-term insurance contract), a trustee of:</del>	
		(i)	<i>an occupational pension scheme in relation to members' benefits which are money-purchase benefits; or</i>
		(ii)	<i>(unless (i) applies) an occupational pension scheme of an employer which is not a large company, large partnership or large mutual association; or</i>
	(b)	...	
...			
(16)	<del>Persons whose claim arises under the Third Parties (Rights against Insurers) Act 1930 [deleted]</del>		
(17)	<del>Where the claim is in relation to a protected contract of insurance or protected non-investment insurance mediation, body corporate, partnerships, mutual associations and unincorporated associations which are not small businesses.</del>		
...			
(20)	<u>Where the claim is in relation to protected debt management business, any person other than a natural person.</u>		

- 4.2.3 R ~~A person who is a small business is an eligible claimant in respect of a relevant general insurance contract entered into before commencement only if the person is a partnership. [deleted]~~

...

#### 4.3 Exceptions: Circumstances where a person coming within COMP 4.2.2R may receive compensation

~~Deposits (and balances in dormant accounts)~~

...

## Long term insurance

- 4.3.2 R ~~A person other than one which comes within any of categories (7), (9), (12) or (15) of COMP 4.2.2R is eligible to claim compensation in respect of a long term insurance contract. [deleted]~~

## Relevant general insurance contracts

- 4.3.3 R ~~(1) A person falling within categories (1)-(4) of COMP 4.2.2R is eligible to claim compensation in respect of a relevant general insurance contract if, at the date the contract commenced he was a small business.~~
- ~~(2) Where the contract has been renewed, the last renewal date shall be taken as the commencement date. [deleted]~~
- 4.3.4 R ~~A partnership which falls within category 14, or category 17, or both of COMP 4.2.2R is eligible to claim compensation in respect of a relevant general insurance contract entered into before commencement. [deleted]~~

...

## Liability subject to compulsory insurance

- 4.3.6 R A person who comes within COMP 4.2.2R is eligible to claim compensation in respect of a liability subject to compulsory insurance if the claim is:
- ~~(1) a claim under a protected contract of insurance; or~~
- ~~(2) a claim in connection with protected non-investment insurance mediation.~~

...

## Eligibility to claim in specified circumstances

- 4.3.8 R The FSCS may treat a person who comes within category (7) or (12) of COMP 4.2.2R as eligible to claim compensation where:
- (1) this is desirable to achieve the efficient performance of any of its functions, including, without limitation, ~~to facilitate a transfer of business or any part thereof, to secure the issue of policies by another firm to eligible claimants in substitution for their existing policies, to achieve the efficient payment of compensation, to secure under COMP 3.3.2CR the payment of benefits under a long term insurance contract;~~ and
- (2) treating these persons as eligible to claim compensation would, in the opinion of the FSCS, be beneficial to the generality of eligible

*claimants* who will be affected by the action in (1).

...

## 5 Protected claims

...

### 5.2 What is a protected claim?

5.2.1 R A *protected claim* is:

- (1) ~~a claim for a protected deposit or a protected dormant account (see COMP 5.3); or [deleted]~~
- (2) ~~a claim under a protected contract of insurance (see COMP 5.4); or [deleted]~~
- (3) ...
- ...
- (5) a claim in connection with *protected non-investment insurance mediation* (see COMP 5.7) ; or
- (6) a claim in connection with protected debt management business (see COMP 5.8).

...

#### Claims in respect of Law Society members etc

5.2.3 R Notwithstanding COMP 5.2.1R and paragraph (4) of the definition of participant firm, where the *relevant person* is in default:

...

### 5.3 ~~Protected deposits and protected dormant accounts [deleted]~~

5.3.1 R [deleted]

5.3.1A R ~~A protected deposit continues to be a protected deposit if, under a transfer of banking business, it is transferred to:~~

- (1) ~~an establishment of a relevant person in the United Kingdom; or~~
- (2) ~~a branch of a UK firm which is a credit institution established in another EEA State under an EEA right.~~

5.3.2 R [deleted]

COMP 5.4 (Protected contracts of insurance) is deleted in its entirety. The deleted text is not shown.

## 5.5 Protected investment business

5.5.1 R *Protected investment business* is:

...

(6) the intermediation of structured deposits,

provided that the territorial scope condition in COMP 5.5.2R is satisfied and, for a *firm* acting as the manager or *depository* of a *fund*, one of the conditions in COMP 5.5.3R is satisfied.

...

### Managers and depositaries of funds

5.5.3 R The conditions referred to in COMP 5.5.1R for a manager or *depository* of a *fund* are:

- (1) for the activities of *managing an AIF, managing a UCITS or establishing, operating or winding up a collective investment scheme*, the *claim* is in respect of an investment in:
  - (a) an *authorised fund*; or
  - (b) any other *fund* which has its registered office or head office in the *UK* or is otherwise domiciled in the *UK* unless it is an *AIF* that is a *body corporate* and not a *collective investment scheme*.
- (2) where a *firm* is acting as *depository* of ~~an *AIF* and in doing so is carrying on the activity of acting as trustee or depository of an *AIF* or safeguarding and administering assets~~ a *fund*, the *claim* is in respect of their activities for:
  - (a) an *authorised AIF fund*; or
  - (b) a *charity AIF* unless it is a *body corporate* that is not a *collective investment scheme*.

...

Insert the new section COMP 5.8 after COMP 5.7 (Protected non-investment insurance mediation). All the text is new and is not underlined.

## 5.8 Protected debt management business

- 5.8.1 R *Protected debt management business* is debt management activity carried out by a *CASS debt management firm* in relation to which the *CASS debt management firm* receives or holds *client money*, provided that the *claim* brought by the *eligible claimant* is in respect of a *shortfall* in *client money* and the conditions in *COMP 5.8.2R* are satisfied.
- 5.8.2 R The conditions referred to in *COMP 5.8.1R* are that the *protected debt management business*:
- (1) was with a *customer* who is habitually resident in the *United Kingdom* or in any other *EEA State*; and
  - (2) was carried on from an establishment maintained by the *relevant person* in the *United Kingdom*.

...

Amend the following as shown.

## 6 Relevant persons and successors in default

...

### 6.2 Who is a relevant person?

...

- 6.2.2 G (1) ~~An incoming EEA firm, which is a credit institution, an IMD insurance intermediary, a MiFID investment firm or an MCD mortgage credit intermediary and its appointed representatives are not relevant persons in relation to the firm's passported activities, unless it has top-up cover. (See definition of "participant firm").~~
- (2) ~~An EEA UCITS management company providing collective portfolio management services for a UCITS scheme from a branch in the United Kingdom or under the freedom to provide cross border services, is a relevant person to the extent that it carries on those services.~~
- (3) ~~An EEA UCITS management company carrying on the activities of managing investments (other than collective portfolio management), advising on investments or safeguarding and administering investments, is not a relevant person in relation to those services, unless it has top-up cover.~~
- (4) ~~An incoming EEA AIFM managing an authorised AIF from a branch in the UK or under the freedom to provide cross border services, is a~~

~~relevant person in respect of that activity.~~

- (5) ~~An incoming EEA AIFM managing an unauthorised AIF is not is a relevant person in respect of that activity unless it has top-up cover.~~
- (6) ~~An incoming EEA AIFM providing the services in article 6(4) of AIFMD is not is a relevant person in relation to those activities, unless it has top-up cover. [deleted]~~

### 6.3 When is a relevant person in default?

6.3.1 R A relevant person is in default if:

- (1) (except in relation to an ~~ICD claim or DGD claim~~) the FSCS has determined it to be *in default* under ~~COMP 6.3.2R, COMP 6.3.3R, or COMP 6.3.4R or COMP 6.3.5R~~; or
- (2) (in relation to an ~~ICD claim or DGD claim~~):
- (a) the ~~appropriate regulator~~ FCA has determined it to be *in default* under ~~COMP 6.3.2R~~; or
- (b) a judicial authority has made a ruling that had the effect of suspending the ability of *eligible claimants* to bring *claims* against the *participant firm*, if that is earlier than (a); and

if a *relevant person* is *in default* in relation to an ~~ICD claim or a DGD claim~~ it shall be deemed to be *in default* in relation to any other type of *protected claim*.

6.3.1A G [**Note:** article 1(3)(i) 2(2) of the ~~Deposit Guarantee Investor Compensation Directive~~]

6.3.2 R Subject to ~~COMP 3.3.3R to COMP 3.3.6R and COMP 6.3.6R~~, the The FSCS (or, where ~~COMP 6.3.1R(2)(a)~~ applies, the ~~appropriate regulator~~ FCA) may determine a *relevant person* to be *in default* when it is, in the opinion of the ~~FSCS~~ or the ~~appropriate regulator~~ FCA:

- (1) unable to satisfy *protected claims* against it; or
- (2) likely to be unable to satisfy *protected claims* against it.

6.3.3 R Subject to ~~COMP 6.3.6R~~ the The FSCS may determine a *relevant person* to be *in default* if it is satisfied that a *protected claim* exists (other than an ~~ICD claim or DGD claim~~), and the *relevant person* is the subject of one or more of the following proceedings in the *United Kingdom* (or of equivalent or similar proceedings in another jurisdiction):

...

6.3.4 R ~~For claims arising in connection with protected investment business, protected home finance mediation or protected non-investment insurance mediation, the The FSCS has the additional power to may determine that a relevant person is to be in default if it is satisfied that a protected claim exists (other than an ICD claim against a successor that is an MiFID investment firm), and:~~

...

~~Members in default and the Central Fund of the Society~~

...

### **6.3A When is a successor in default?**

...

6.3A.4 R ~~For claims arising in connection with protected investment business, protected home finance mediation or protected non-investment insurance mediation, the The FSCS has the additional power to may determine that a successor is to be in default if it is satisfied that a protected claim exists (other than an ICD claim against a successor that is an MiFID investment firm), and:~~

...

...

## **7 Assignment or subrogation of rights**

...

### **7.2 How does the assignment of rights work?**

...

~~Provisions relating to other classes of protected claim~~

...

Claims arising under COMP 3.2.4R

7.2.7 R (1) ...

...

### **7.3 Automatic subrogation**

7.3.1 R ~~The FSCS's powers in this section apply to all *claims* except those under *protected contracts of insurance*. [deleted]~~

...

7.3.10 R (1) The *FSCS* may determine that:

...

(c) if it is otherwise necessary or desirable in conjunction with the exercise of the *FSCS*'s powers under *COMP* 7.3.8R or *COMP* 7.3.9R ~~or *COMP* 15.1.9R~~;

...

...

**7.5 ~~Recoveries: protected deposits~~ [deleted]**

**7.6 ~~Recoveries: claims other than for protected deposits~~ Treatment of recoveries**

7.6.1 R If the *FSCS* makes recoveries in relation to a *claim* ~~that is not for a *protected deposit*~~, it may deduct from any recoveries paid over to the claimant under *COMP* 7.6.2R part or all of its reasonable costs of recovery and distribution (if any).

7.6.2 R Unless compensation was paid under *COMP* 9.2.3R ~~or the *claim* was for a *protected deposit*~~, if a claimant assigns or transfers his rights to the *FSCS* or a claimant's rights and claims are otherwise subrogated to the *FSCS* and the *FSCS* subsequently makes recoveries through those rights or claims, those recoveries must be paid to the claimant:

...

7.6.3 R For the purpose of *COMP* 7.6.2R compensation received by *eligible claimants* in relation to *Lloyd's policies contracts of insurance* written at *Lloyd's* may include payments made from the *Central Fund*.

7.6.4 R ~~Except for a *claim* for a *protected deposit*, the~~ The *FSCS* must endeavour to ensure that a claimant will not suffer disadvantage arising solely from his prompt acceptance of the *FSCS*'s offer of compensation or from the subrogation of his rights and claims to the *FSCS* compared with what might have been the position had he delayed his acceptance or had his claims not been subrogated.

...

**10 Limits on the amount of compensation payable**

...

**10.2 Limits on compensation payable**

...

## 10.2.3 R Table Limits

This table belongs to COMP 10.2.1R

Type of claim	Level of cover	Maximum payment
...		
<i>Protected non-investment insurance mediation</i>	(1) where the <i>claim</i> is in respect of a <i>liability subject to compulsory insurance</i> : 100% of <i>claim</i>	Unlimited
	(2) where the <i>claim</i> is in respect of: (a) a <i>relevant omission</i> ; and (b) a <i>professional indemnity insurance contract</i> <u>professional indemnity insurance contract</u> , or would be in respect of a <i>professional indemnity insurance contract</i> <u>professional indemnity insurance contract</u> , if the insurance contract had been effected: 100% of <i>claim</i>	Unlimited
	...	...
<i>Protected debt management business</i>	<u>100% of claim</u>	<u>£50,000</u>

...

~~Continuity of insurance cover~~

...

~~Claims in respect of protected dormant accounts~~

...

## 11 Payment of compensation

...

### 11.2 Payment

...

11.2.2A R Where a claimant has a *claim* that falls within *COMP* 12A.3.1R, the *FSCS* may pay any compensation to:

- (1) the *participants* and not to the claimant; or
- (2) the *collective investment scheme* and (where different) not to the claimant; or
- (3) any combination of the above.

11.2.2B G As a result of *COMP* 12A.3.1R, the *FSCS* must try to ensure that the amount paid is no more than the amount of the loss suffered by the participant.

...

Form and method of paying compensation

11.2.3A R The *FSCS* may pay compensation in any form and by any method (or any combination of them) that it determines is appropriate including, without limitation:

...

- (2) by paying compensation directly into an existing deposit account (or for the benefit of) the claimant, or as otherwise identified by (or on behalf of) the claimant, with an *authorised person* (but before doing so the *FSCS* must take such steps as it considers appropriate to verify the existence of such an account and to give notice to the claimant of its intention to exercise this power) ; and/or
- (3) ~~(where two or more *persons* have a joint beneficial *claim*) by accepting communications from and/or paying compensation to any one of those *persons* where this is in accordance with the terms and conditions for communications and withdrawals of the *protected deposit*; and/or [deleted]~~

...

...

11.2.6 R The *FSCS* may not pay a lesser sum in final settlement under *COMP* 11.2.4R and *COMP* 11.2.5R where the *claim* is ~~a *DGD claim* or~~ an *ICD*

*claim.*

...

## 12 Calculating compensation

...

### 12.2 Quantification: general

...

12.2.2 R ~~COMP 12.2.1R~~ 12.2.1AR is, however, subject to the other provisions of *COMP*, in particular those *rules* that set limits on the amount of compensation payable for various types of *protected claim*. The limits are set out in *COMP* 10.

12.2.3 G Where a liability of a *relevant person* (or, where applicable, a *successor*) to an *eligible claimant* could fall within more than one type of ~~*protected claim*~~ claim protected by the FSCS whether under the rules of the FCA (see *COMP* 5.2.1R) or of the PRA, for example a *claim* in connection with money held by ~~an~~ a *MiFID investment firm* that is also a *credit institution*, the *FSCS* should seek to ensure that the claimant does not receive any further compensation payment from the *FSCS* in cases where the claimant has already received compensation from the *FSCS* in respect of that *claim*.

...

#### Payments to the claimant

12.2.7A R The *FSCS* must take into account any payments to the claimant (including amounts recovered by the *FSCS* on behalf of the claimant) made by the *relevant person* (or, where applicable, a *successor*) or the *FSCS* or any other *person*, including any payment made by the FSCS under the PRA's rules, if that payment is connected with the *relevant person's* liability to the claimant in calculating the claimant's overall *claim*.

...

#### Settlement of claims

12.2.10 R (1) ...

(2) This *rule* does not apply with respect to *claims* that are excluded by ~~Article 2 of the Deposit Guarantee Directive or by Article~~ article 3 of the *Investor Compensation Directive*.

## 12.3 Quantification date

...

Protected debt management business

- 12.3.9 R For a *claim* made in connection with *protected debt management business*, the *FSCS* must determine a specific date as the *quantification date*, and this date may be either on, before or after the date of determination of default.

**12.4 The compensation calculation**

...

- 12.4.4 R If the claimant has an *ICD claim* against an *incoming EEA firm* which is a *MiFID investment firm* ~~(including a *credit institution* which is a *MiFID investment firm*)~~ or, where applicable, a *successor* of such a *firm*, the *FSCS* must take account of the liability of the *Home State* compensation scheme in calculating the compensation payable by the *FSCS*.

...

## Protected investment business: excessive benefits

...

- 12.4.16 R ~~For *claims* arising in connection with *protected contracts of insurance*, the *FSCS* must treat any term in an *insurance undertaking's* constitution or in its *contracts of insurance*, limiting the undertaking's liabilities under a *long-term insurance contract* to the amount of its assets, as limiting the undertaking's liabilities to any claimant to an amount which is not less than the gross assets of the undertaking. [deleted]~~

...

Protected debt management business

- 12.4.21A R The *FSCS* may pay compensation for any *claim* made in connection with *protected debt management business* only to the extent that the *FSCS* considers that the *payment of compensation is essential in order to provide the claimant with fair compensation.*

...

**12.6 Quantification: ~~trustees, operators of pension schemes, persons winding up pension schemes, personal representatives, agents and joint claims~~**

Trustees, operators of pension schemes and persons winding up pension schemes

- 12.6.1 R If a claimant's *claim* includes a *claim* as:
- (1) trustee; or

- (2) ~~the operator of, or the person carrying on the regulated activity of winding up, a stakeholder pension scheme (which is not an occupational pension scheme) or personal pension scheme,~~

~~the FSCS must treat him in respect of that claim as if his claim was the claim of a different person.~~

~~[deleted]~~ **[Note: COMP 12.6.1R now appears at COMP 12A.1.1R]**

- 12.6.2 R If a claimant has a *claim* as a bare trustee or *nominee company* for one or more beneficiaries, the *FSCS* must treat the beneficiary or beneficiaries as having the *claim*, and not the claimant.

~~[deleted]~~ **[Note: COMP 12.6.2R now appears at COMP 12A.1.2R]**

- 12.6.2A R If a claimant has a *claim*:

- (1) ~~as the trustee of an occupational pension scheme or the trustee or operator of, or the person carrying on the regulated activity of winding up, a stakeholder pension scheme (which is not an occupational pension scheme) or personal pension scheme; and~~

- (2) ~~for one or more members of a pension scheme (or, where relevant, the beneficiary of any member) whose benefits are, or include, money purchase benefits;~~

~~the FSCS must treat the member or member scheme (or, where relevant, the beneficiary of any member) as having the claim, and not the claimant (insofar as members' benefits are money purchase benefits).~~

~~[deleted]~~ **[Note: COMP 12.6.2AR now appears at COMP 12A.1.3R]**

- 12.6.3 R If any group of *persons* has a *claim* as:

- (1) ~~trustees; or~~

- (2) ~~operators of, or as persons carrying on the regulated activity of winding up, a stakeholder pension scheme (which is not an occupational pension scheme) or personal pension scheme,~~

~~(or any combination thereof), the FSCS must treat them as a single and continuing person distinct from the persons who may from time to time be the trustees, operators or persons winding up the relevant pension scheme.~~

~~[deleted]~~ **[Note: COMP 12.6.3R now appears at COMP 12A.1.4R]**

- 12.6.4 R Where the same *person* has a *claim* as:

- (1) ~~trustee for different trusts or for different stakeholder pension schemes (which are not occupational pension schemes) or personal pension schemes; or~~

- (2) ~~the operator of, or the person carrying on the regulated activity of winding up, different stakeholder pension schemes (which are not~~

~~occupational pension schemes) or personal pension schemes,~~

~~COMP applies as if the claims relating to each of these trusts or schemes were claims of different persons.~~

~~[deleted] [Note: COMP 12.6.4R now appears at COMP 12A.1.5R]~~

- 12.6.5 R ~~Where the claimant is a trustee, and some of the beneficiaries of the trust are persons who would not be eligible claimants if they had a claim themselves, the FSCS must adjust the amount of the overall claim to eliminate the part of the claim which, in the FSCS's view, is a claim for those beneficiaries.~~

~~[deleted] [Note: COMP 12.6.5R now appears at COMP 12A.1.6R]~~

- 12.6.6 R ~~Where any of the provisions of COMP 12A.6.1R to 12A.6.5R apply, the FSCS must try to ensure that any amount paid to:~~

~~(1) the trustee; or~~

~~(2) the operator of, or the person carrying on the regulated activity of winding up, a stakeholder pension scheme (which is not an occupational pension scheme) or personal pension scheme,~~

~~is, in each case:~~

~~(3) for the benefit of members or beneficiaries who would be eligible claimants if they had a claim themselves; and~~

~~(4) no more than the amount of the loss suffered by those members or beneficiaries.~~

~~[deleted] [Note: COMP 12.6.6R now appears at COMP 12A.1.7R]~~

#### Personal representative

- 12.6.8 R ~~Where a person numbers among his claims a claim as the personal representative of another, the FSCS must treat him in respect of that claim as if he were standing in the shoes of that other person.~~

~~[deleted] [Note: COMP 12.6.9R now appears at COMP 12A.2.1R]~~

#### Agents

- 12.6.9 R ~~If a claimant has a claim as agent for one or more principals, the FSCS must treat the principal or principals as having the claim, not the claimant.~~

~~[deleted] [Note: COMP 12.6.9R now appears at COMP 12A.2.2R]~~

#### Joint claims

- 12.6.10 R ~~If two or more persons have a joint beneficial claim, the claim is to be treated as a claim of the partnership if they are carrying on business together in partnership. Otherwise each of those persons is taken to have a claim for his share, and in the absence of satisfactory evidence as to their respective shares, the FSCS must regard each person as entitled to an equal share.~~

~~[deleted] [Note: COMP 12.6.10R now appears at COMP 12A.2.3R]~~

#### Foreign law

- 12.6.11 R ~~In applying COMP to claims arising out of business done with a branch or establishment of the relevant person outside the United Kingdom, the FSCS must interpret references to:~~
- ~~(1) persons entitled as personal representatives, trustees, bare trustees or agents, operators of pension schemes or persons carrying on the regulated activity of winding up pension schemes; or~~
  - ~~(2) persons having a joint beneficial claim or carrying on business in partnership;~~

~~as references to persons entitled, under the law of the relevant country or territory, in a capacity appearing to the FSCS to correspond as nearly as may be to that capacity.~~

~~[deleted] [Note: COMP 12.6.11R now appears at COMP 12A.4.1R]~~

#### Claims arising under COMP 3.2.4R

- 12.6.12 R ~~If a firm has a claim under COMP 3.2.4R, the FSCS must treat each customer of the firm as having the claim for the purposes of calculating compensation within COMP 12.~~

~~[deleted] [Note: COMP 12.6.12R now appears at COMP 12A.5.1R]~~

Insert the new chapter COMP 12A after COMP 12 (Calculating compensation). All the text is new and is not underlined.

## 12A Special cases

### 12A.1 Trustees and pension schemes

- 12A.1.1 R If a claimant's claim includes a claim as:
- (1) trustee; or
  - (2) the operator of, or the person carrying on the regulated activity of winding up, a stakeholder pension scheme (which is not an occupational pension scheme) or personal pension scheme,
- the FSCS must treat him in respect of that claim as if his claim was the claim of a different person.
- 12A.1.2 R If a claimant has a claim as a bare trustee or nominee company for one or more beneficiaries, the FSCS must treat the beneficiary or beneficiaries as

having the *claim*, and not the claimant.

12A.1.3 R If a claimant has a *claim*:

- (1) as the trustee of an *occupational pension scheme* or the trustee or *operator* of, or the *person* carrying on the *regulated activity* of winding up, a stakeholder pension scheme (which is not an *occupational pension scheme*) or *personal pension scheme*; and
- (2) for one or more members of a pension scheme (or, where relevant, the beneficiary of any member) whose benefits are, or include, *money-purchase benefits*;

the *FSCS* must treat the member or member scheme (or, where relevant, the beneficiary of any member) as having the *claim*, and not the claimant (insofar as members' benefits are *money-purchase benefits*).

12A.1.4 R If any group of *persons* has a *claim* as:

- (1) trustees; or
- (2) *operators* of, or as *persons* carrying on the *regulated activity* of winding up, a stakeholder pension scheme (which is not an *occupational pension scheme*) or *personal pension scheme*,

(or any combination thereof), the *FSCS* must treat them as a single and continuing *person* distinct from the *persons* who may from time to time be the trustees, *operators* or *persons* winding up the relevant pension scheme.

12A.1.5 R Where the same *person* has a *claim* as:

- (1) trustee for different trusts or for different *stakeholder pension schemes* (which are not *occupational pension schemes*) or *personal pension schemes*; or
- (2) the *operator* of, or the *person* carrying on the *regulated activity* of winding up, different *stakeholder pension schemes* (which are not *occupational pension schemes*) or *personal pension schemes*,

*COMP* applies as if the *claims* relating to each of these trusts or schemes were claims of different *persons*.

12A.1.6 R Where the claimant is a trustee, and some of the beneficiaries of the trust are *persons* who would not be *eligible claimants* if they had a claim themselves, the *FSCS* must adjust the amount of the overall *claim* to eliminate the part of the claim which, in the *FSCS's* view, is a claim for those beneficiaries.

12A.1.7 R Where any of the provisions of *COMP* 12A.1.1R to *COMP* 12A.1.6R apply, the *FSCS* must try to ensure that any amount paid to:

- (1) the trustee; or

- (2) the *operator* of, or the *person* carrying on the *regulated activity* of winding up, a stakeholder pension scheme (which is not an *occupational pension scheme*) or *personal pension scheme*,

is, in each case:

- (3) for the benefit of members or beneficiaries who would be *eligible claimants* if they had a *claim* themselves; and
- (4) no more than the amount of the loss suffered by those members or beneficiaries.

## 12A.2 Personal representatives, agents and joint claims

- 12A.2.1 R Where a *person* numbers among his *claims* a *claim* as the personal representative of another, the *FSCS* must treat him in respect of that *claim* as if he were standing in the shoes of that other person.
- 12A.2.2 R If a claimant has a *claim* as agent for one or more *principals*, the *FSCS* must treat the *principal* or *principals* as having the *claim*, not the claimant.
- 12A.2.3 R If two or more *persons* have a joint beneficial *claim*, the *claim* is to be treated as a *claim* of the partnership if they are carrying on business together in partnership. Otherwise each of those *persons* is taken to have a *claim* for his share, and in the absence of satisfactory evidence as to their respective shares, the *FSCS* must regard each *person* as entitled to an equal share.

## 12A.3 Collective investment schemes

- 12A.3.1 R (1) If a claimant has a *claim* in its capacity as a *collective investment scheme*, or anyone who is an operator, depositary, manager or trustee of such a scheme, and the conditions in (2) are met:
- (a) the *FSCS* must treat the *participant* or *participants* as having the *claim*, and not the claimant;
- (b) *COMP* 12A.1.6R and *COMP* 12A.1.7R apply, reading “trustee” as “*collective investment scheme*, or anyone who is an operator, depositary, manager or trustee of such a scheme”, “trust” as “*collective investment scheme*” and “beneficiary” as “participant”.
- (2) The conditions referred to in (1) are:
- (a) the *claim* is against a *relevant person*:
- (i) acting in the capacity of *manager* or *depositary* of the

*collective investment scheme*; or

(ii) in connection with that person's *managing investments* or *safeguarding and administering investments*; and

(b) as a result of the matters in (a), a participant in the *collective investment scheme* has suffered loss but the participant has no *claim* for that loss against that *relevant person*.

## 12A.4 Foreign law

12A.4.1 R In applying *COMP* to *claims* arising out of business done with a *branch* or *establishment* of the *relevant person* outside the *United Kingdom*, the *FSCS* must interpret references to:

- (1) *persons* entitled as personal representatives, trustees, bare trustees or agents, *operators* of *pension schemes* or *persons* carrying on the *regulated activity* of winding up *pension schemes*; or
- (2) *persons* having a joint beneficial *claim* or carrying on business in partnership;

as references to *persons* entitled, under the law of the relevant country or territory, in a capacity appearing to the *FSCS* to correspond as nearly as may be to that capacity.

## 12A.5 Claims arising under COMP 3.2.4R

12A.5.1 R If a *firm* has a *claim* under *COMP* 3.2.4R, the *FSCS* must treat each *customer* of the *firm* as having the *claim* for the purposes of calculating compensation within *COMP* 12.

Amend the following as shown.

## 14 Participation by EEA Firms

### 14.1 Application and Purpose

Application

...

14.1.2 R This chapter also applies to an *incoming EEA firm* which is a ~~*credit institution, or an MiFID investment firm (or both)*~~, an *IMD insurance intermediary*, a *UCITS management company*, an *MCD mortgage credit*

*intermediary or an AIFM.*

Purpose

- 14.1.3 G This chapter provides supplementary *rules and guidance*, and contains a broad summary, in guidance, of *FSCS* cover, for an *incoming EEA firm* which is a ~~credit institution~~, an *IMD insurance intermediary*, ~~an~~ a *MiFID investment firm*, a *UCITS management company*, an *MCD mortgage credit intermediary* or an *AIFM*. It reflects in part the implementation of the ~~Deposit Guarantee Directive~~, *Investors Investor Compensation Directive*, and *UCITS Directive*. ~~This sourcebook applies in the usual way to an incoming EEA firm which is exercising EEA rights under the Insurance Directives. Such a firm is not affected by the Deposit Guarantee Directive, the Investors Compensation Directive or the UCITS Directive.~~
- 14.1.4 G (1) An *incoming EEA firm* which is a ~~credit institution~~, an *IMD insurance intermediary*, an *MCD mortgage credit intermediary* or ~~an~~ a *MiFID investment firm* is not a *participant firm* in relation to its *passport activities* unless it "tops-up" into the *compensation scheme*. This reflects section 213(10) of the *Act* (The *compensation scheme*) and regulation 2 of the *Electing Participants Regulations* (Persons not to be regarded as relevant persons). If an *incoming EEA firm* also carries on *non-passported activities* for which the *compensation scheme* provides cover, it will be a *participant firm* in relation to those activities and will be covered by the *compensation scheme* for those activities in the usual way.
- (2) Whether an *incoming EEA firm* which is an *EEA UCITS management company* is a *participant firm* in relation to its *passport activities* depends on the nature of its activities. In so far as it carries on the activities of *managing investments* (other than *collective portfolio management*), *advising on investments* or *safeguarding and administering investments*, it is not a *participant firm* unless it "tops-up" into the *compensation scheme* and it may only obtain top-up cover if it carries on those activities from a branch in the United Kingdom. To the extent that such a *firm* provides *collective portfolio management* services for a *UCITS scheme* from a *branch* in the *United Kingdom* or under the freedom to provide *cross border services*, it is a *participant firm* in respect of those services.
- ...
- 14.1.5 G In relation to an *incoming EEA firm's passport activities*, its *Home State* compensation scheme must provide compensation cover in respect of business within the scope of the ~~Deposit Guarantee Directive~~, *Investors Investor Compensation Directive*, article 6(3) of the *UCITS Directive* and article 6(4) of *AIFMD*, whether that business is carried on from a *UK branch* or on a *cross border services* basis. *Insurance mediation activity relating to non-investment insurance contracts* is not within the scope of the

~~Deposit Guarantee Directive and the Investor Compensation Directive.~~

...

## 14.2 Obtaining top-up cover

...

14.2.3 G A notice under *COMP* 14.2.1R should include details confirming that the *incoming EEA firm* falls within a prescribed category. In summary:

(1) the *firm* must be:

(a) ~~a credit institution;~~ or [deleted]

...

...

...

## 14.3 Co-operation between the FSCS and Home State compensation schemes

14.3.1 R Where an *incoming EEA firm* obtains *top-up cover* under *COMP* 14.2, the *FSCS* must co-operate with that *firm's Home State* compensation scheme. In particular, the *FSCS* must seek to establish with that *firm's Home State* compensation scheme appropriate procedures for the payment of compensation to claimants, following the principles set out in ~~Annex II of the Deposit Guarantee Directive or~~ Annex II of the *Investor Compensation Directive*, as appropriate.

~~[Note: article 4(5) of the Deposit Guarantee Directive]~~

## 14.4 Ending top-up cover

FSCS terminating top-up cover

...

14.4.2 R If an *incoming EEA firm* which has *top-up cover* fails to observe any of the *rules* in this sourcebook which apply to *participant firms*, the *FSCS* must notify the ~~appropriate regulator~~ FCA and the *incoming EEA firm's Home State regulator*.

...

*COMP* 15 (Protected deposits: Payments from other schemes) and *COMP* 16 (Disclosure requirements for firms that accept deposits) are deleted in their entirety. The deleted text is not shown.

**TP 1 Transitional Provisions**

## TP 1.1 Transitional Provisions Table

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook Provisions coming into force
...					
40	<u>Amendments introduced by the FSCS Funding and Scope Instrument 2017</u>	<u>R</u>	The changes referred to in (2) do not apply in relation to a <i>claim</i> against a <i>relevant person</i> , or against a <i>successor</i> , that was <i>in default</i> before 1 April 2018.	From 1 April 2018 indefinitely	1 April 2018

...

**Sch 2 Notification requirements**

## Sch 2.1G

1.	The aim of the guidance in the following table is to give the reader a quick overall view of the relevant requirements for notification and reporting. In all cases, other than those concerning <del>Chapter 13, Chapter 14 and 17</del> and the Transitional Provisions, the notification rules in <i>COMP</i> apply only to the FSCS (the scheme manager).
...	

## Sch 2.2G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>COMP</i> 2.2.5G	Annual Report	Not specified in <del>COMP</del> <i>COMP</i> – see Memorandum of Understanding (MoU) between each regulator	End of Financial Year	Not specified in <del>COMP</del> <i>COMP</i> (see MoU)

		<del>the FCA and FSCS</del> <u>the FSCS</u>		
...				
<del>FEES 6.2.1R</del> <u>6.2.1AR</u>	Right to exemption for specific costs and compensation costs levy	Notice that firm does not conduct business that could give rise to a claim on the <del>FSCS</del> <u>FSCS</u> and has no reasonable likelihood of doing so	If it does not, or if it ceases to, conduct business with persons eligible to claim on <del>FSCS</del> <u>the FSCS</u> , unless it has already given such notice.	None specified although exemption generally only takes effect from the date of receipt of notice by <del>FSCS</del> <u>the FSCS</u>
...				
<del>FEES 6.5.13R</del>	Levy base for participant firm	The contribution groups to which the participant firm belongs. The total amount of business (measured in accordance with the appropriate tariff bases, which it conducted as at 31 December of the previous year)	The end of the calendar year (the occasion of 31 December every year beginning with 31 December 2001)	By end February <u>or the date requested by the FCA where the firm becomes a participant firm part way through the financial year</u>
...				
<del>COMP TP 29R(2) and COMP 17.2.7R</del>	<del>Election or revocation of election that the <i>electronic SCV rules</i> do not apply.</del>	<del>See Matter to be notified</del>	<del>See Matter to be notified</del>	<b>Immediately</b>
<del>COMP 17.2.7R(1)</del>	<del>Election that the <i>electronic SCV rules</i> do not apply.</del>	<del>See Matter to be notified</del>	<del>See Matter to be notified</del>	<b>Immediately</b>

<i>COMP</i> 17.2.7R(1A)	Revocation of election that the <i>electronic SCV rules</i> do not apply.	See Matter to be notified	See Matter to be notified	Immediately
<i>COMP</i> 17.2.7R(2)	The <i>firm</i> has operated 5,000 or more accounts held by <i>eligible claimants</i> for two consecutive years, having previously operated less than 5,000	See Matter to be notified	See Matter to be notified	Immediately
<i>COMP</i> 17.3.1R	A <i>firm</i> must provide the <i>PRA</i> with an <i>SCV implementation report</i> and <i>SCV report</i>	See <i>COMP</i> 17.3.6R(1) or <i>COMP</i> 17.3.6R(2) as applicable and <i>COMP</i> 17.3.9R(1) or <i>COMP</i> 17.3.9R(2) as applicable.	Receipt of <i>permission to accept deposits</i> or <i>obtaining top-up cover</i> as applicable	Three months
<i>COMP</i> 17.3.2R	A <i>firm</i> must provide the <i>PRA</i> with an <i>SCV implementation report</i> and <i>SCV report</i>	See <i>COMP</i> 17.3.6R(1) or <i>COMP</i> 17.3.6R(2) as applicable and <i>COMP</i> 17.3.9R(1) or <i>COMP</i> 17.3.9R(2) as applicable.	A material change in the <i>firm's SCV system</i>	Three months
<i>COMP</i> 17.3.4R	A <i>firm</i> must provide the <i>PRA</i> with an <i>SCV report</i>	<i>COMP</i> 17.3.9R(1) or <i>COMP</i> 17.3.9R(2) as applicable.	Every four years (starting on 31 December 2010 or the date of receiving <i>permission to accept deposits</i> or in the case of an <i>incoming EEA firm</i> the date of <i>obtaining top-up cover</i> ;	See Trigger event

			whichever is later)	
<i>COMP</i> TP 30R(2) and <i>COMP</i> 17.2.7R	Election or revocation of election that the <i>electronic SCV rules</i> do not apply	See Matter to be notified	See Matter to be notified	Immediately

...

**Sch 5 Rights of action for damages**

...

Sch 5.2G

...

Chapter/Appendix	Section/Annex	Paragraph	For private person?	Removed	For other person ?
<i>COMP</i> 1	5	8	No	Yes – <i>COMP</i> 1.5.11G <u>1.5.12R</u>	No
...					

## Annex F

### Amendments to the Consumer Credit sourcebook (CONC)

In this Annex, underlining indicates new text.

#### **3 Financial promotions and communications with customers**

...

#### **3.9 Financial promotions and communications: debt counsellors and debt adjusters**

...

3.9.1A R The obligation in CONC 3.9.3R(16) only applies to a CASS debt management firm.

...

Contents of financial promotions and communications

3.9.3 R A *firm* must ensure that a *financial promotion* or a communication with a *customer* (to the extent a previous communication to the same *customer* has not included the following information) includes:

...

(16) an explanation that compensation might be available from the FSCS if there is a *shortfall* in *client money* held by the *firm* for that *customer*.

...

#### **8 Debt advice**

##### **8.1 Application**

...

8.1.3A R CONC 8.3.1R(14) only applies to a CASS debt management firm.

...

##### **8.3 Pre contract information and advice requirements**

8.3.1 R A *firm* must (except where the contract is a *credit agreement* to which the *disclosure regulations* apply) provide sufficient information, in a *durable medium*, when the *customer* first enquires about the *firm's* services, about the following matters to enable the *customer* to make a reasonable decision:

...

(14) an explanation that compensation might be available from the FSCS if there is a *shortfall in client money* held by the *firm* for that *customer*.

...

...



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