

# CP13/1\*\*\*

Financial Services Authority

## FSCS Funding Model Review

– feedback on CP12/16 and further consultation



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The Financial Services Authority invites comments on this Consultation Paper. Comments should reach us by 18 February 2013.

Comments may be sent by electronic submission using the form on the FSA's website at: [www.fsa.gov.uk/Pages/Library/Policy/CP/2013/cp13-01-response.shtml](http://www.fsa.gov.uk/Pages/Library/Policy/CP/2013/cp13-01-response.shtml).

**Alternatively, please send comments in writing to:**

Caroline Donellan  
Conduct, Redress & Standards Department  
Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

**Telephone:** 020 7066 2598

**Email:** [cp13\\_01@fsa.gov.uk](mailto:cp13_01@fsa.gov.uk)

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It is the FSA's policy to make all responses to formal consultation available for public inspection unless the respondent requests otherwise. A standard confidentiality statement in an email message will not be regarded as a request for non-disclosure.

A confidential response may be requested from us 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 Tribunal.

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Copies of this Consultation Paper are available to download from our website – [www.fsa.gov.uk](http://www.fsa.gov.uk). Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

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# Abbreviations used in this paper

<b>AEI</b>	Annual eligible income
<b>CBA</b>	Cost benefit analysis
<b>CIS</b>	Collective Investment Schemes
<b>DGSD</b>	Deposit Guarantee Schemes Directive
<b>FCA</b>	Financial Conduct Authority
<b>FSCS</b>	Financial Services Compensation Scheme
<b>HFFA</b>	Home Finance Providers and Administrators
<b>MELL</b>	Management expenses levy limit
<b>PRA</b>	Prudential Regulation Authority
<b>RAO</b>	Regulated Activities Order
<b>RDR</b>	Retail Distribution Review



# 1

## Overview

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- 1.1 In July 2012 we published a review of the funding arrangements of the Financial Services Compensation Scheme (FSCS). A well-funded and sustainable compensation scheme is important for financial stability and consumer confidence – and all financial services firms benefit from this. The aim of the package of proposals in CP12/16<sup>1</sup> was to establish a credible funding approach for the FSCS, one which balances the need for adequacy of funds with affordability for those contributing.
- 1.2 The FSCS is funded by two types of industry levy: a compensation costs levy and a management expenses levy. The compensation costs levy raises money to pay the claims of consumers, while the management expenses levy relates to the money raised to fund the FSCS's annual operational costs.
- 1.3 Compensation costs are allocated to groups of firms (referred to as 'FSCS funding classes' or 'classes') that have permission to undertake regulated activities that share a degree of affinity. When compensation costs of a class exceed a maximum amount ('annual threshold') other classes are required to contribute to the funding of any remaining compensation costs.
- 1.4 The main changes we proposed in CP12/16 were:
- Revised annual thresholds for the FSCS funding classes (based on an assessment of affordability).
  - Two separate approaches for funding compensation costs in excess of FSCS annual class thresholds: one for the Prudential Regulation Authority (PRA) FSCS funding classes and one for the Financial Conduct Authority (FCA) FSCS funding classes with no funding support between the two.<sup>2</sup>

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1 CP12/16 *FSCS Funding Model Review* (July 2012); [www.fsa.gov.uk/static/pubs/cp/cp12-16.pdf](http://www.fsa.gov.uk/static/pubs/cp/cp12-16.pdf).

2 From 1 April 2013, the two regulators will decide how the FSCS will be funded, but the PRA and FCA will each have distinct rule-making responsibilities: the PRA for claims for deposits and under insurance contracts (i.e. insurance claims following the failure of an insurer) and the FCA for all other claims (including claims in the investment sector and those related to regulated mediation activities including insurance).

- A retail pool in which FCA classes would participate. Pay-outs from this pool would be triggered only if one or more classes reached their annual threshold.
- A revised approach for determining the amount FSCS can raise as a compensation costs levy for all but the Deposits class, by extending the horizon for the assessment of compensation the FSCS expects to pay, from 12 months to three years after the date of the levy (referred to in this document as our ‘expected compensation costs’ proposal).

1.5 In this paper we summarise the feedback to CP12/16 and our response. We also confirm the final rules except in one area (relating to the funding of the FCA retail pool), where we are undertaking a further one-month consultation, to close on 18 February 2013.

## What do we cover in this paper?

1.6 This paper covers revised proposals on spreading costs in Chapter 3 and our response to the key themes that emerged from our consultation in CP12/16. We received 57 responses to CP12/16 and are grateful for the industry’s input to the consultation process.

## Chapter 2

1.7 This chapter is about class composition (i.e. the criteria which determines the allocation of firms to funding groups; attribution of compensation costs to funding groups; and allocation of costs by way of levy) and tariff measures (i.e. the measures against which firms report annual tariff data and which are used to determine each individual firm’s corresponding share of a class levy). Our conclusions and recommendations in CP12/16 on both of these issues were among the key themes of industry feedback.

1.8 This chapter confirms that we will proceed as outlined in CP12/16: class composition and structure will continue to be determined by the regulated activities a firm has permission to undertake and the current tariff measures will continue to apply to all FSCS funding classes.

## Chapter 3

1.9 This chapter addresses how to fund costs that exceed FSCS funding class thresholds (comments received on our proposed thresholds are considered in Chapter 4). It confirms that we will proceed with the elements of the CP12/16 proposals specific to how costs in excess of PRA FSCS funding class thresholds should be spread, after ‘legal cutover’ i.e. when the regulators become FCA and PRA on 1 April 2013. However, there were concerns about our proposed FCA retail pool. We remain committed to finding a workable solution among the potentially competing interests of different sectors. So, in Chapter 3 we put

forward an alternative proposal. The proposal would require all firms that are regulated by the FCA, including providers, to make contributions when the pool is triggered by claims arising from the intermediation classes.

- 1.10** The FSA is consulting on the retail pool rule changes to be made by the FCA. The draft Handbook text included in Appendix 1 includes some changes to FSA rules which are currently intended to be adopted – in identical form – by both the FCA and the PRA on 1st April 2013. However, if the FCA makes the retail pool rule changes, the rules will be different for the PRA and FCA from 1 April 2013.
- 1.11** This is a revised proposal from that in CP12/16. So to give stakeholders the opportunity to comment, **we are consulting again. However, this is over a shortened one-month period.** This is to ensure that, subject to the outcome of this revised consultation, the new funding model can be implemented from 1 April 2013. **Please send us your comments on the proposal by 18 February 2013.**

## Chapter 4

- 1.12** This chapter is about annual FSCS funding class thresholds i.e. the maximum amount that an FSCS funding class can be called upon to pay by way of a levy in any given levy year. Firms may also be required to contribute to costs to the FCA retail pool (up to relevant thresholds) if they are members of the FCA provider contribution classes as described in Chapter 3.
- 1.13** It confirms that all the annual FSCS funding class thresholds which we proposed in CP12/16 will apply from 1 April 2013.

## Chapter 5

- 1.14** In this chapter, we respond to the feedback we received about reducing volatility. From year to year there can be significant peaks and troughs in the number of firm failures and the number and value of FSCS compensation claims, making it difficult for levy-paying firms to anticipate and provision for FSCS compensation cost levies.
- 1.15** In light of the feedback received, Chapter 5 explains that we have:
- deferred the implementation date of our ‘expected compensation costs’ proposal by a year; and
  - amended some of our Handbook rules to provide clarity and legal certainty in relation to how and when the FSCS funds compensation costs. The FSCS is also committed to publishing the principles that guide its funding decisions; this commitment will be

included in the Memoranda of Understanding (MoUs) between the FSCS and the PRA and FCA post legal cutover.

## Chapter 6

- 1.16** This chapter clarifies how the annual management expenses levy limit (MELL) will be approved after legal cutover in light of the responsibilities of both the PRA and FCA in this area. It also responds to some other issues that were raised in the feedback to the consultation.
- 1.17** There are also five annexes and two appendices:
- Annex 1: our cost benefit analysis of the revised proposal for the FCA retail pool;
  - Annex 2: our compatibility statement of the revised proposal for the FCA retail pool;
  - Annex 3: the consultation question;
  - Annex 4: a table of FSCS funding classes and their corresponding regulated activities;
  - Annex 5: a list of all the non-confidential respondents to CP12/16;
  - Appendix 1: Draft Handbook Text
  - Appendix 2: Designation of Handbook Provisions
  - Appendix 3: Made rules (legal instrument)
- 1.18** The made Handbook text (Appendix 3) does not differ significantly from that consulted on in CP12/16, except that we are now consulting on a revised policy and new rules for the FCA retail pool. This new consultation is also subject to a new cost benefit analysis, and compatibility statement.
- 1.19** We continue to consider that neither the made Handbook text nor the revised FCA retail pool proposal influences behaviour or creates barriers to equality of opportunity. This is because FSCS fees are based on objective measures which aim to ensure proportionate levies. Furthermore, consumers are not directly affected because, in improving the funding arrangements for the FSCS, it is our intention that consumers' access to, and experience of, the FSCS should not be reduced.

## Who should read this document?

- 1.20** This document will interest all firms regulated by the FSA, whether current or potential contributors to FSCS funding.

## CONSUMERS

This document may interest consumers or consumer groups as the proposals relate to the funding of the Financial Services Compensation Scheme. The FSCS is a key source of protection for consumers as it can provide compensation to customers of authorised financial services firms that are unable to meet claims. For further information see [www.fscs.org.uk](http://www.fscs.org.uk).

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# 2

## FSCS funding classes and tariff measures

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- 2.1 In this chapter we provide feedback on the responses we received to CP12/16 on the composition of FSCS funding classes and tariffs within each class.
- 2.2 Many respondents expressed disappointment that we proposed to retain the current basis of allocation. Of these responses, most raised issues unique and specific to the interests of their class(es), but in effect most argued for a greater degree of risk differentiation in the funding model (to differentiate between firms in a class according to the potential risk they pose to the FSCS).
- 2.3 We did not receive any alternative proposals for determining the class structure of the FSCS funding model as a whole, although some respondents from the intermediation sectors suggested we should replace the entire model with product levies. A few respondents called for a reconsideration of pre-funding.

### **FSCS funding classes**

- 2.4 To ensure the funding model is clear and certain for both firms and the FSCS, there must be objective and recognised criteria on which to:
- allocate firms to funding groups;
  - attribute compensation costs to funding groups; and
  - allocate costs by way of levy.
- 2.5 The allocation criteria in the current funding model are the regulated activities that firms have permission to undertake. In CP12/16, we explained why, in our view, none of the

alternatives we examined<sup>3</sup> struck a more reasonable balance between fairness, affinity, stability, clarity and sustainability.

2.6 We asked:

*Q2: Do you have any comment on our analysis of the alternative bases of allocation and class structures or any suggestions for further consideration?*

*Q3: Do you have any comment on our analysis or proposal to retain the current approach?*

2.7 On balance, most respondents broadly support the concept of alignment to the regulated activities a firm has permission to undertake, although some raised concerns about the Regulated Activities Order (RAO) and questioned its ability to accurately reflect:

- the permissions and authorisations firms hold under European directives; and
- the full range of firms' business activities.

2.8 Some respondents proposed further subdivision of their classes to reflect different levels of risk, including splitting them by:

- business model (some respondents in the building society sector);
- primary activity (e.g. a detailed proposal for separating 'pure' insurance brokers from all other firms in the general insurance intermediation class);
- applicable prudential regime (some respondents in the investment sector); and
- a split between execution only and advisory firms (one respondent from the Investment Intermediation class).

2.9 Each of these proposals suggest regulated activities should not be the sole determinant for class composition: they all adopt allocation by regulated activities as their starting platform, with further division into sub-classes on the basis of additional characteristics and criteria.

### Our response

We acknowledge that reliance on the RAO has certain limitations (for example, in terms of consistency with the specific terminology, permissions and authorisations under applicable European directives) but unless the RAO changes which we understand to be unlikely, there are limited alternative options. No basis of

<sup>3</sup> Establish a single class per broad sector; establish more classes per broad sector; allocation to class by primary business; allocation to class by product; and classification by regulatory requirement.

allocation is perfect, but a class structure linked to the RAO provides stable and objective criteria for the allocation of firms, costs and levies. It also ensures that the allocation of compensation costs is aligned to the activities that cause them.

The current approach requires, in the first instance, that firms pay the costs generated by failed firms with permissions to undertake similar regulated activities. We are conscious that because similarity between firms is not necessarily the same as similarity between activities, some firms believe this is unfair because they pay for the failings of firms with whom they feel little affinity.

Nevertheless, we consider that the suggestions we received for further division into smaller classes would represent a significant and undesirable departure from the current basis of allocation: compensation costs would no longer be adequately aligned to the activities that cause them. The FSCS would have to attribute the costs to only one of multiple classes whose firms have permission to undertake those activities.

To divide the current classes would increase the total number of funding classes in the model. Each of these classes would have smaller membership and lower thresholds, making them potentially unaffordable and therefore unsustainable. In turn, the risk that firms in other classes could be called upon to provide funding support would increase.

CP12/16 explained that any process of allocation needs to be: easy to understand; capable of reliable and consistent application; robust and not requiring constant reassessment; economical and operationally capable of practical administration; and result in sustainable classes. Overall, we are not convinced that any of the proposed alternatives meet these criteria or strike a more reasonable balance between fairness, affinity and sustainability than the current approach. For example:

- The operational proposal to separate ‘pure insurance brokers’ from ‘other insurance intermediaries’ within the General Insurance Intermediation class<sup>4</sup> would create an approach that:
  - o *is difficult to understand;*  
Determining the class to which a firm with general insurance intermediation permissions should be allocated would require three additional tests.<sup>5</sup>
  - o *requires frequent re-assessment;*  
It would require periodic review and recalculation of the appropriate threshold for the additional new assessment criteria.

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<sup>4</sup> [www.biba.org.uk/UploadedFiles/653bibareport.pdf](http://www.biba.org.uk/UploadedFiles/653bibareport.pdf)

<sup>5</sup> Based on: permissions held by the firm, the firm’s regulated income as a proportion of total income, and the volume of insurance products sold by the firm as a proportion of its total product sales.

- o *leads to potentially unstable class composition; and*  
The additional new assessment criteria could cause the composition (and therefore capacity) of the class to change from year to year.
- o *carries implementation costs and system build implications for firms and FSA (or FCA after 1 April 2013).*  
Firms would have to submit additional new data each year.
- Using prudential requirements<sup>6</sup> would create a significant number of sub-classes (which would lead to sustainability concerns) and give rise to a gaming risk as it is possible for firms to move between regimes.
- Using firms' RAO permissions to separate 'Execution-Only' brokers from 'advisory firms' may create an artificial distinction as many 'Execution-Only' brokers have permissions in common with other investment intermediaries that also have advice permissions. This could lead to inaccurate and inconsistent tariff data submissions to the resulting classes.
- To isolate building societies and mutuals from banks, would not only be inconsistent with the treatment of deposit takers in the Banking Consolidation and Capital Requirements Directives<sup>7</sup> and the Deposit Guarantee Schemes Directive (DGSD), but would also produce a new, potentially unsustainable class that is materially exposed to its largest members. Also, some banks operate similar business models to building societies.

In addition, we found limited evidence to support some respondents' assertion that the resulting sub-classes would present distinctly different risks to the FSCS:

*Proposal to separate by prudential requirements:*

- The level and risk of exposure to the FSCS is not determined by a firm's solvency alone. In general, the prudential regimes are not calibrated on the basis of risks that are relevant to all FSCS claims such firms could generate so they are not currently a useful indicator of the amount of consumer harm that could arise from breaches of conduct requirements. In due course it is expected that the FCA intends to review its approach to prudential regulation, and the extent to which its requirements reflect the risks of the underlying activities. Risk-based levies are also under consideration under the DGSD as mentioned in paragraph 2.15.

*Proposal to separate 'Execution-Only' brokers from 'advisory firms':*

- There is no clear evidence to suggest 'execution-only brokers' are any more or less likely to fail financially than 'advisory firms', nor that they are more or less likely to breach a legal duty owed to a consumer in respect of any of the permissions they may hold in common with a number of 'advisory firms'

<sup>6</sup> When we refer to prudential requirements in this context we mean in particular the applicable financial resource requirements (such as the level and quality of capital) flowing from the national and international regulatory prudential regimes.

<sup>7</sup> Banking Consolidation Directive (2006/48/EC) and Capital Requirements Directive (2006/49/EC).

We continue to believe allocation by regulated activities strikes the most reasonable balance between fairness, affinity and sustainability. It has the certainty which makes it capable of application by both firms and the FSCS. If firms want their contributions to the FSCS more closely to reflect risk, adjustments to tariff measures would be more appropriate than a series of unique class composition manipulations.

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## Pre-funding

- 2.10** As set out in CP12/16, pre-funding requires a change in regulations and the decision whether or not to make the required change is a decision for the Government. A few respondents nevertheless urged us to reconsider introducing pre-funding.
- 2.11** As stated in CP12/16 a case can be made for moving to a pre-funded model for the intermediation classes. An established pre-fund could increase the funding capacity for these classes and so reduce the need for alternative sources of funding. A pre-fund could reduce volatility by smoothing costs to firms and reduce some unpredictability, as defaults in the intermediation classes are frequent but costs, for example as a result of mis-selling, are unpredictable.
- 2.12** Our statutory power is limited to enabling the FSCS to impose levies on firms to meet expenses that it expects to incur. A pre-fund, by contrast, requires levies to be raised irrespective of a default occurring.
- 2.13** Whether to change regulations on pre-funding for these classes remains a decision for the Government. Pre-funding for deposit takers is not considered here as the DGSD remains under discussion.

## Tariff measures

- 2.14** The share of any levy that firms pay for the class(es) in which they participate is determined by a specific ‘tariff measure’. This aims to ensure that a firm’s contribution to FSCS levies is proportionate to the amount of protected business undertaken by firms in the class. The greater a firm’s volume of protected business, the greater the contribution it must make to the levy.
- 2.15** In CP12/16, we explained that we had investigated some alternative measures and possible metrics for levy adjustments, but found that these were either unfeasible, lacked merit or

were not credible. So we recommended keeping the existing measures. We did not consider the deposits class as we are waiting for clarity after the proposed recast of the DGSD.

### Product levies

**2.16** In CP12/16 we acknowledged the calls by some stakeholders for product levies<sup>8</sup> to either replace the current funding model, or to feature as a tariff measure within the existing framework. We did not propose introducing product levies because, despite their potential to improve the predictability of levies, there were also some policy downsides and practical barriers, for example, difficulties in:

- differentiating the risk attached to different types of products and transactions; and
- incorporating some recognition of the distinctions between the activities of provision and intermediation.

**2.17** We asked:

*Q20: Do you agree that the existing tariff measures are preferable to product levies? If not, how do you suggest the concerns expressed above could be addressed?*

**2.18** Some respondents to the CP advocated product levies, but more agreed with our conclusions. Those in favour strongly endorse the benefits we noted in the CP and contend that product levies<sup>9</sup> are the most desirable and sustainable funding mechanism because they:

- are more transparent and would increase consumer awareness of the FSCS and the corresponding cost of protection;
- are simpler for firms to understand; and
- make firms' contributions more predictable and therefore easier to provide for.

**2.19** We were also interested to note some common suggestions for addressing some of the practical obstacles we had identified.

- Fairness considerations would suggest the need for risk differentiation

Contrary to the majority of responses to other questions in the CP, some respondents dispute the need for risk differentiation within product levies or suggest that the adjustment need not be particularly sophisticated.

- Intermediaries would play no role in the funding of the FSCS

<sup>8</sup> Although there may be variations, a product levy is likely to be a levy attached to the transaction/sale of a product at the outset (not the product itself) which is set at a fixed amount and added to the product price paid by the end consumer. The income would be used to build up some sort of fund from which claims could be paid.

<sup>9</sup> A very small number of respondents suggested, however, that the cost of the levy should not be explicitly disclosed to consumers as it may deter them.

Levies could be raised as a percentage of income, effectively capturing the provision of advice as a ‘product’.

- 2.20** CP12/16 noted that both domestic and European legislation envision compensation schemes that are industry, rather than consumer, funded. A few advocates of product levies did not consider this a barrier to the operation of product levies because, in their view, consumers already contribute indirectly to the cost of FSCS funding. Product levies, they argue, would ensure that cost pass-through applies in a more consistent and transparent manner.

### Our response

Ultimately, product levies would lead to the build-up of a fund for the benefit of meeting costs from indeterminate future defaults, which is not currently possible. We acknowledge that some of the responses identified valid ways to overcome some of the obstacles we outlined in CP12/16. They also provide a good basis for a longer term debate, should we get further legislative clarity, including in the context of European directive requirements. At this time, however, we are not persuaded that we could introduce product levies.

## Other tariff measure adjustments

- 2.21** The figure which firms in the intermediation classes must submit as tariff data each year (which is used to determine their share of any levy raised against that class), is ‘annual eligible income’ (AEI).<sup>10</sup> In CP12/16, we considered whether there were ways of supplementing this calculation with further measures to take account of the likelihood of firms generating claims to the FSCS. CP12/16 explained that we were unable to find any reliable indicators.<sup>11</sup>

*Q19: Do you agree that annual eligible income remains preferable to gross income as a tariff measure for the Intermediation classes?*

*Q21: Do you agree that the metrics considered would not reliably adjust the tariff measure to reflect the likelihood of claims on the FSCS?*

<sup>10</sup> The definition of ‘annual eligible income’ varies between the intermediation classes.

<sup>11</sup> Options considered include: number of complaints; permission to hold client money; permission to provide advice; FSA risk scores of firms; number of complaints upheld by FOS; types of products sold; and amount of capital held.

*Q22: If not, which metric(s) do you propose that would demonstrably meet our criteria of reliability, transparency, objectivity, comprehensiveness, confidentiality, and cost-effectiveness?*

- 2.22** Of the responses from participants in the intermediation classes, most agreed that AEI should be retained as it is fairer than gross income. Few suggested tariff adjustment metrics other than those already assessed in the CP. Despite our conclusions, there were continued calls for a differential treatment of firms providing investment advice and those operating execution-only models.<sup>12</sup> We discuss below some of the concerns expressed about applying AEI to collective investment schemes.
- 2.23** Respondents from other classes also responded to these questions, with some calling for new risk-based levies in the Deposits class to reflect the business model operated by building societies more closely.

### **Our response**

As per our proposals in CP12/16, we will retain the AEI tariff measure for the intermediation classes and not introduce tariff adjustments. The suggestions from CP respondents did not appear to meet our criteria, most particularly reliability, objectivity and cost effectiveness. So we are unconvinced they would lead to a fairer allocation of levies than the current approach.

We are not considering tariff issues for the Deposits class at this time because we are awaiting greater clarity on the on-going negotiations on the DGSD.

## **Other issues specific to the investment classes**

### **Renaming the Investment Fund Management class**

- 2.24** CP12/16 proposed that we rename the Investment Fund Management class the ‘Investment Provision’ class to make it clear that it is not limited to fund managers.
- 2.25** Of the small number of comments we received, few strong views were expressed on the proposed name change, although some queried whether it would make the composition of the class clearer. A very small number of respondents misunderstood and thought we proposed to change the composition of the class. This was not our intention.

<sup>12</sup> For example by using arbitrary multipliers or by applying separate metrics to each individual permission within a class (a complex exercise for firms as it would require them to identify and report data against individual activities and it assumes that reliable metrics can be identified for each permission).

### **Our response**

In the absence of any clear expressions of dissent, we will change the name of the class.

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#### **Safeguarding permissions in the Investment Intermediation class**

- 2.26** CP12/16 explained that we could consider reallocating the regulated activities of ‘safeguarding and administering investments’ and ‘arranging safeguarding and administering of assets’ from the Investment Intermediation class to the Investment Provision class. We asked whether we should consider this in greater detail.
- 2.27** We do not propose taking this forward, as responses indicated that moving the permissions creates the potential for disproportionate complexities in identifying and accurately reporting tariff data.

#### **Investment Provision class – reporting income from Collective Investment Schemes (CIS)**

- 2.28** In CP12/16, we explained that there were issues concerning how ‘annual eligible income’ should apply in respect of CIS income but that FSCS had confirmed (in June 2012) how this income should be reported. A number of firms have since sought to re-submit their tariff data and many CP respondents expressed concerns about whether the class remains sustainable following these re-submissions.
- 2.29** The extent of any redistributive effects will not be clear until we have received the next annual round of levy data submissions. So we will monitor the situation closely, and when we receive the data we will consider the appropriateness of both the tariff measure and our threshold analysis.

# 3

## Spreading costs: including revised consultation proposal

3.1 In CP12/16 we proposed changes to how costs in excess of funding class thresholds would be spread. We have considered and respond to comments received on our proposed thresholds in Chapter 4.

3.2 Specifically, we proposed that:

- There should be no cross-subsidy from, to or between the PRA FSCS funding classes.
- Costs in excess of PRA class thresholds would be met by another FSCS funding source and repaid by the originating class over time.
- There should be no cross-subsidy between the PRA and FCA FSCS funding classes.
- Costs in excess of FCA FSCS funding class thresholds should be met from an FCA pool made up of the FCA FSCS funding classes.<sup>13</sup> If the pool is triggered, the other future FCA FSCS funding classes would contribute to the funding requirement in proportion to their thresholds.

3.3 We asked:

*Q6: Do you agree with our recommendation to end cross-subsidy from, to and between PRA classes?*

<sup>13</sup> In CP12/16 we proposed that the Home Finance Provision class will be removed from the funding model as it would not be capable of generating compensation claims to be paid from the pool. The FCA FSCS funding classes are: General Insurance Intermediation, Life & Pensions Intermediation, Investment Intermediation Home Finance Intermediation and Investment Provision (formerly Investment Fund Management).

*Q7: In the absence of direct funding support from the PRA classes, do you agree with our recommendation to establish an FCA retail pool?*

- 3.4 Most respondents generally supported the proposals and the rationale for discontinuing cross-subsidy from, to and between PRA FSCS funding classes.
- 3.5 Many respondents however questioned the rationale for distinguishing between product providers and intermediaries. They argued that:
- There is a close affinity between providing and distributing products so providers should have to contribute to the cost of funding claims on the FSCS arising from the design and distribution of financial products.
  - It would be more logical for providers and intermediaries that share some affinity to support each other than it would be for intermediaries with no affinity to each other.
  - Cross-subsidy might distort incentives for firms in a class to do proper risk management, as they know they can rely on firms outside the class to provide support.
- 3.6 In particular, most respondents expressed concerns about what they considered to be the disproportionate burden on the Investment Provision class (formerly the Investment Fund Management class) as it will be the only provider class supporting the intermediation classes. Some respondents considered that the class should be excluded from the FCA retail pool to become a standalone class identical to the PRA FSCS funding classes.
- 3.7 Some respondents suggested that:
- The different treatment of PRA and FCA FSCS funding classes is inconsistent and any mutual support should also be removed for all FCA classes.
  - If mutual support was also removed for the FCA classes, funding needs in excess of FCA class thresholds should also be met by borrowing.
  - If the combined threshold for the intermediation classes is reached, PRA classes should be called upon to contribute to the FCA retail pool.
- 3.8 Many respondents also highlighted the need for greater transparency of the FSCS's financing agreements.

### **Our response**

In view of the feedback, we continue to believe there should be no mutual contributions from, to and between PRA FSCS funding classes.

However, we believe that some form of mutual support should be maintained for FCA FSCS funding classes so that the FSCS can fund a significant call on a class.

This is because all firms subject to FCA regulation will have a mutual financial interest in maintaining the confidence of consumers who use the markets in which they operate. We acknowledge that this undermines the exclusion of product providers from the FCA retail pool.

We remain committed to the ‘standalone’ PRA classes as set out in CP12/16. However, as no firm is solely PRA regulated we propose to make changes to our proposals on how the FCA retail pool would be composed and operated based on the following principles:

- FCA regulated (including dual-regulated) provider firms should contribute to FSCS funding needs for the intermediation classes (which typically arise from conduct failings) and which breach FCA class thresholds.
- Provider firms’ contributions should be independent from any contributions they already make to FCA intermediation FSCS funding classes (e.g. banks’ investment intermediation activities).
- Contributions would not be made from the PRA FSCS funding classes (although contributions would be from firms which are part of the PRA funding classes as they, too, are FCA regulated) and would be set out in FCA rules.

We think this revised funding model strikes a reasonable balance between extending the funding capacity of the scheme while ensuring that no sector is threatened by potentially unaffordable levies.

So, the FSA is consulting on the retail pool rule changes to be made by the FCA. The draft Handbook text included in Appendix B includes some changes to FSA rules which are currently intended to be adopted – in identical form – by both the FCA and the PRA on 1st April 2013. However, if the FCA makes the retail pool rule changes, the rules will be different for the PRA and FCA from 1 April 2013.

The remainder of this chapter consults on the details of this amended proposal. While the change falls within the scope of original consultation and so we could have just made these rules, we want you to have the opportunity to comment on the details of the proposal. So we can implement the new model by 1 April 2013, please **respond to this consultation by 18 February 2013**.

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## Revised FCA retail pool design features

### Inclusion of FCA provider contribution classes

- 3.9** We propose a revised FCA retail pool which mirrors the FCA retail pool set out in CP12/16. It is made up of the following FCA FSCS funding classes: General Insurance

Intermediation, Life and Pensions Intermediation, Investment Intermediation, Home Finance Intermediation and Investment Provision.

- 3.10** In addition to these FCA FSCS funding classes we propose that deposit takers, general insurers, life insurers and home finance providers also contribute to the pool if any of the thresholds of the FCA Intermediation classes are reached.<sup>14</sup> However, they will not receive support from the pool. We believe it is reasonable to include them to reflect the role of providers in conduct-driven failures. We aim to achieve this by implementing FCA provider contribution classes, which will be based on the composition of the corresponding future FCA regulatory fee blocks. Costs levied from the FCA provider contribution classes will also be allocated based on the tariff measures of the corresponding FCA regulatory fee block.
- 3.11** The FCA provider contribution classes will contribute to the FCA retail pool in the event that the threshold of one or more of the intermediation funding classes is reached but these classes will not receive support from the pool.
- 3.12** The Investment Provision FSCS funding class already forms part of the FCA retail pool as consulted on in CP12/16. As is the case with the other FCA FSCS funding classes, it will be required to provide support and will potentially receive funding support from the pool if its threshold is reached. We believe this is necessary to ensure there will not be a funding gap if there is a significant call on the FSCS from a firm in this class.
- 3.13** Under the revised FCA retail pool each FCA FSCS funding class will continue to fund the claims arising within the class. However, if the threshold of one of the intermediation classes is reached the FCA provider contribution classes and remaining FCA FSCS funding classes will contribute to the FCA retail pool.
- 3.14** We considered whether the Investment Provision class should receive support from the other FCA provider contribution classes. But this would not seem appropriate because the relationship between FCA providers and the intermediation sector is not the same as the relationship between FCA providers and the investment provision class. We expect that the FCA provider firms would object to supporting another provider class.

### **Inclusion of home finance providers**

- 3.15** The new approach will mean, as under the current model, potential contributions from home finance providers.<sup>15</sup> In CP12/16 we argued that because the regulated activities that form the legal basis of the Home Finance Provision FSCS funding class are not subject to FSCS protection they should not contribute to the FCA retail pool. But as we are including other provider contribution classes in the FCA retail pool because they share a mutual

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<sup>14</sup> The retail pool could be triggered and used in the event of a threshold being reached for specific and/or compensation costs.

<sup>15</sup> Unlike the current model, contributions from the home finance providers could be required to fund compensation costs from any of the intermediation classes, not just the home finance intermediation class.

financial interest in consumer confidence with the intermediation classes, it follows logically that home finance providers should also contribute to the FCA retail pool.

### Using FCA regulatory fee blocks to reflect providers' responsibility

- 3.16** We have considered a range of options for estimating the contributions from the FCA provider contribution classes and believe it should reflect the conduct responsibilities of providers. We aim to achieve this by basing the class thresholds of the FCA provider contribution classes (except the Investment Provision class) on the fees to be paid by firms in the future FCA regulatory fee blocks<sup>16</sup> (not the FSCS funding classes).
- 3.17** We estimate that FCA regulated providers (excluding those within the Investment Provision class) will contribute around 25% of FCA regulatory fees in 2013/14. We think the FCA providers should pay a similar percentage amount towards the FCA retail pool.

**Table 1: FCA Provider Contribution classes**

FCA provider contribution class	Corresponding future FCA conduct-regulated fee-blocks	Class threshold
Deposit acceptors contribution class	A.1: Deposit acceptors	£110m
Insurers – general contribution class	A.3: Insurers – general	£35m
Insurers – life contribution class	A.4: Insurers – life	£70m
Home finance providers and administrators contribution class	A.2: Home finance providers and administrators	£45m

- 3.18** The inclusion of the FCA provider contribution classes in the FCA retail pool makes it more likely that the funding capacity of the pool is large enough to absorb potential claims arising from conduct failings. The combined capacity of £1,050m is made up of the aggregate of the FCA FSCS funding classes' thresholds (£790m) and the aggregate FCA provider contribution classes' thresholds (£260m – around 25% of the FCA retail pool capacity). The contribution of each provider class in the £260m is then allocated relative to their share in FCA regulatory fee blocks.
- 3.19** We believe that a 25% combined share from provider contribution classes is reasonable and strikes an adequate balance between the impact on providers and aiming to give the FCA retail pool enough funds to meet compensation needs and maintain consumer confidence.
- 3.20** One potential disadvantage of this model is some inconsistency in the treatment of providers, as the contribution of the investment providers to the FCA retail pool is determined by the FSCS funding class thresholds rather than through a proxy for their conduct-related responsibilities as suggested by their future FCA fee blocks as is the case

<sup>16</sup> The relevant future FCA regulatory fee blocks for the FCA provider contribution classes will be Deposit Acceptors, Insurers – Life, Insurers – General and Home Finance Providers and Administrators. For more details on our policy proposals for regulatory fees and levies in 2013/14 see CP12/28: [www.fsa.gov.uk/static/pubs/cp/cp12-28.pdf](http://www.fsa.gov.uk/static/pubs/cp/cp12-28.pdf).

with the FCA provider contribution classes. This is because the Investment Provision class will be able to receive as well as provide support, so we believe it appropriate to base its contributions on its FSCS funding class liability.

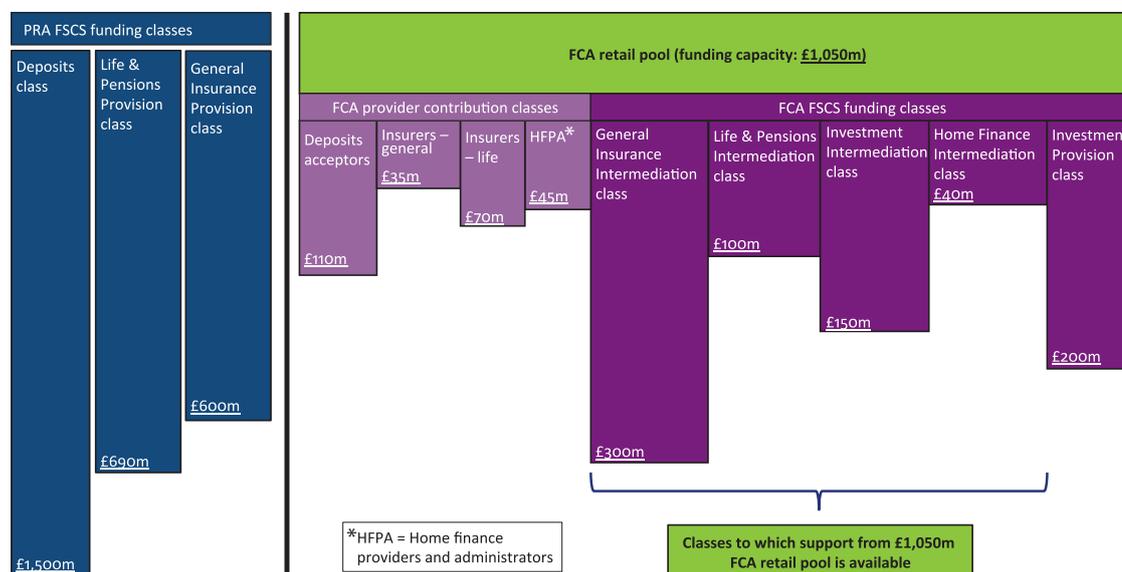
3.21 Chart 1 reflects the proposal set out in CP12/16 and shows the FCA retail pool in case compensation costs exceed the Investment Provision class threshold.

**Chart 1: FCA retail pool – for compensation costs exceeding the Investment Provision class threshold only**



3.22 Chart 2 shows the FCA retail pool for the scenario that a class threshold in one or more of the FCA Intermediation classes is breached.

**Chart 2: Revised FCA retail pool – for compensation costs exceeding an FCA Intermediaries class threshold**



**3.23** Because all firms regulated by the FCA (including dual-regulated firms) have a mutual financial interest in maintaining consumer confidence, FCA providers are included in the FCA retail pool. However, to avoid a disproportionate impact on providers:

- The firms within the FCA provider contribution classes will not be required to contribute to the pool if the threshold in their corresponding PRA FSCS funding class has already been reached.

So, if the General Insurance Provision class was levied £600m, the Insurers – general FCA provider contribution class would not be levied if the FCA retail pool was triggered.

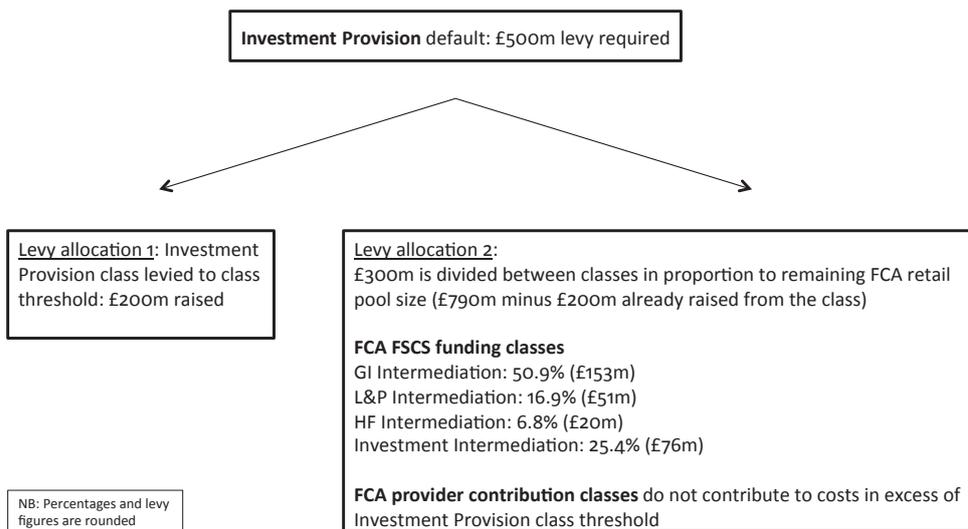
- And if the FCA retail pool was triggered first, but within the same financial year there is a subsequent call on a PRA FSCS funding class that is expected to meet or exceed its threshold, the FSCS must, so far as reasonably possible seek to refund monies already paid by the corresponding FCA provider contribution class. It could do this by raising an interim levy from classes within the FCA retail pool. If, for instance, the entire capacity of the retail pool had been used, then the FSCS might seek to borrow any required amount. If, for whatever reason, the FSCS is unable to recover the monies, firms could be levied up to the maximum threshold of both the PRA FSCS funding class(es) and the FCA provider contribution class(es) within a given year, but we do not believe this is very likely.

### Illustrative examples of cost allocation under the proposed model

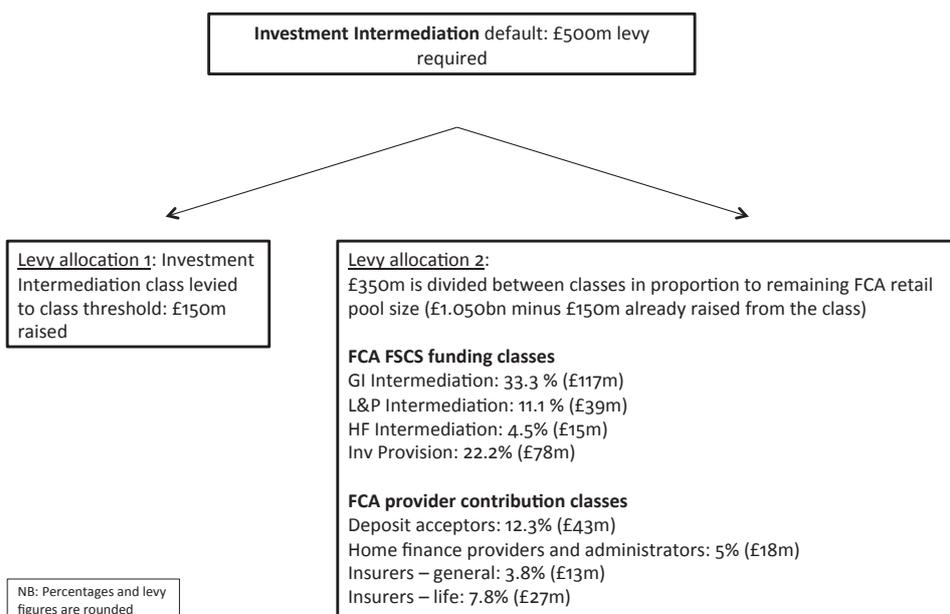
**3.24** The model being proposed would see costs exceeding the threshold of any individual FCA FSCS funding class being spread among a wider group. The examples below show the

allocation of costs to each of the FCA FSCS funding classes and the FCA provider contribution classes.

- 3.25 The diagram shows how costs would be allocated in the event a default requiring a levy of £500m was required from the Investment Provision class.



- 3.26 The diagram below shows how costs would be allocated in the event a default requiring a levy of £500m was required from the Investment Intermediation class.



**Q1:** Do you have any comments on our proposal?

# 4

## Annual class thresholds

- 4.1** In CP12/16 we proposed changes to the class thresholds, which determine how much each class can be required to pay each year. When reviewing the class thresholds we aimed to strike an appropriate balance between affordability to firms and potential funding needs for each class.
- 4.2** To assess affordability to firms, we asked Deloitte to model the impact of different potential thresholds on individual firms.<sup>17</sup> We then compared the impacts on firms from the Deloitte report to the funding needs of each class based on historic and average claims data. The modelling showed that under the existing thresholds the impact on profits was spread differently between the classes and we sought to reduce these differences by changing some of the thresholds.
- 4.3** We also took into account the fact that if the threshold for a class was set too low, the cost over time to firms within the class could be higher, even though the immediate payment burden on firms is lower. For instance, where borrowing is used to provide additional or an alternative funding source a lower threshold could mean loans having to be spread over a longer period, with correspondingly higher accruing interest costs.

**Table 2: Current and proposed FSCS class thresholds**

Class	Current threshold	Proposed threshold
Deposits	£1,840m	£1,500m
General Insurance Provision	£775m	£600m
Life and Pensions Provision	£690m	£690m
Investment Fund Management	£270m	£200m
General Insurance Intermediation	£195m	£300m
Life and Pensions Intermediation	£100m	£100m
Investment Intermediation	£100m	£150m
Home Finance Intermediation	£60m	£40m

<sup>17</sup> The full report from Deloitte: [www.fsa.gov.uk/pubs/other/deloitte-29mar12.pdf](http://www.fsa.gov.uk/pubs/other/deloitte-29mar12.pdf)

- 4.4 The respondents were largely in favour of thresholds that were reduced or retained and critical of those that were increased. However, some respondents who felt they were likely to be called upon to support other classes argued for higher caps in order to minimise the risk of being called on.
- 4.5 We asked specific questions in relation to the individual thresholds which are dealt with later in the chapter. We also received a number of responses that were not specific to any individual class threshold but applicable across all classes. They concerned:
- modelling parameters; and
  - transparency about judgements.

## Modelling parameters

- 4.6 Some respondents noted that the modelling only took into account the impact on firms on a one-year basis. It did not assess the cumulative impact of successive years of levying at the upper range of the class thresholds.

### Our response

We sought to review the viability of class thresholds in a more sophisticated way than previously. We did this by assessing the impact on firms' profits and surplus capital if a threshold was reached, using the most recent financial year-end data for all 16,000 plus firms that participate in the FSCS.

This approach has allowed us to arrive at more robust threshold recommendations than before and to set them at levels that produce roughly comparable impacts across the classes.

The Deloitte report shows that the modelling to achieve this was highly complex, taking account of numerous economic and regulatory cost scenarios, firm segments, and multiple assumptions for each of the classes. Expanding the analysis to a multi-year period would have made it much more complex and the results more speculative and therefore less reliable.

So we believe that our methodology is reasonable given the constraints. We have also committed to regularly reviewing annual thresholds as part of our FSCS funding review, which in the past has tended to be every three to five years.

## Transparency about judgements

- 4.7 Some respondents felt that the CP did not set out in detail how we made judgements in relation to the funding needs of classes and affordability to firms.

### Our response

The modelling of the impact of the thresholds options relies on a complex analytical framework set out in detail in the Deloitte report. Our subsequent decisions on the thresholds was a judgement between the competing demands of affordability (as modelled) and historic and existing funding needs (as assessed by reference to respective historical data).

We did not use confidential information (e.g. the number of firms expected to default in the future) to make those judgements. In broad terms we have sought to reduce differences in the impact on profits across the classes but have accepted higher impacts where historical calls on the class have been significant.

## Individual class thresholds

### Class threshold for the Deposits class

- 4.8 We asked:

*Q8: Do you agree with our proposal to set the class threshold for the Deposits class at £1.5bn a year?*

- 4.9 Some respondents thought that the model's assumption of £1bn for legacy costs and DGSD pre-funding underplays DGSD payments.

### Our response

The modelling of the Deposits class threshold (of £1.5bn a year) took account of an aggregate £1bn a year for contributions to both a possible DGSD pre-fund and FSCS legacy costs repayments ('legacy cost levies').

Legacy cost levies in 2013/14, 2014/15 and 2015/16 are currently estimated at around £750m to £800m a year, which would cover the interest on the borrowing needed to fund the 2008 defaults, as well as estimated unrecovered principal amounts on the Heritable Bank, Kaupthing Singer & Friedlander, Landsbanki

‘Icesave’ and London Scottish Bank plc defaults. After 2015/16 payments are expected to relate only to ongoing interest repayments.

The £1.5bn threshold, and our modelling of £1bn a year, is based on an assumption that any pre-fund potentially required under the DGSD could be built up progressively. But clearly this will depend on the final wording of the DGSD.

We will set the threshold for the Deposits class at £1.5bn a year.

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## Class threshold for the General Insurance Provision class

4.10 We asked:

*Q9: Do you agree with our proposal to set the class threshold for the General Insurance Provision class at £600m a year?*

4.11 We only received a small number of responses to this question, with most in favour of the proposal.

### Our response

We will set the threshold for the General Insurance Provision class at £600m a year.

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## Class threshold for the Life and Pensions Provision class

4.12 We asked:

*Q10: Do you agree with our proposal to set the class threshold for the Life and Pensions Provision class at £690m a year?*

4.13 We only received a small number of responses to this question, with the majority in favour of the proposal.

### Our response

We will set the threshold for the Life and Pensions Provision class at £690m a year.

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## Class threshold for the Investment Provision class

4.14 We asked:

*Q11: Do you agree with our proposal to set the class threshold for the Investment Fund Management class at £200m a year?*

4.15 We only received a few responses to this question, with about half of respondents in favour of the proposal.

4.16 One respondent argued that the reduction in the threshold was too great given that under the FCA retail pool any claims arising within this class exceeding the class threshold would have to be funded by the other FCA classes.

4.17 It was also suggested that because many firms in the Investment Provision class are also members of other classes – and in particular the Investment Intermediation class – the increase in the threshold for the Investment Intermediation class and the decrease in the threshold of the Investment Provision class should be more closely aligned.

### Our response

When setting the individual class thresholds we sought to strike a balance between affordability and potential funding need.

We therefore believe the reduction in the threshold for the Investment Provision class is reasonable and will set the threshold for the Investment Provision class at £200m a year.

## Class threshold for the General Insurance Intermediation class

4.18 We asked:

*Q12: Do you agree with our proposal to set the class threshold for the General Insurance Intermediation class at £300m a year?*

4.19 Some respondents argued that the cumulative impact on general insurance intermediation firms that also undertake other, secondary activities is underestimated.

4.20 Some respondents also felt that the CP did not justify the increase to £300m.

## Our response

Our approach to the General Insurance Intermediation class has been to balance the competing demands of affordability (as modelled) and potential funding need (based on historical data).

The threshold in the General Insurance Intermediation class was not arrived at through a formula, but was the result of a judgement that took account of affordability as well as the increase in funding need since 2008.

The analysis included in the CP outlined the potential impact that raising the maximum threshold would have on firms in this class. We consider that the potential impact continues to be reasonable in light of the responses we received. We see no reason why this class cannot afford a threshold closer to (but still below) the 20% benchmark which applies for other classes.

Importantly, the threshold represents a maximum that can be levied from this class annually which is reliant on the number and volume of claims received by the FSCS. This can be from claims costs arising in the class, or via the revised FCA retail pool.

In addition, we noted in the consultation that we modelled the worst-case scenario of all FSCS thresholds being reached at the same time, and the impact did not undermine our proposals.

We believe the impact of levies from secondary activities is unlikely to be significant, as costs are allocated to firms in proportion to their share in the levy base of the class. That share is likely to be low because the additional activities are very minor and there are thousands of firms in the classes.

## Class threshold for the Life and Pensions Intermediation class

4.21 We asked:

*Q13: Do you agree with our proposal to set the class threshold for the Life and Pensions Intermediation class at £100m a year?*

4.22 We only received a small number of responses to this question, with about half of respondents in favour of the proposal.

4.23 One respondent noted that despite a rise in claims on the FSCS arising from this class, the threshold has remained unchanged for a number of years.

### Our response

As with the other classes we have sought to balance the competing demands of affordability and potential funding need when setting the Life and Pensions Intermediation class threshold. On that basis we will set the threshold for the Life and Pensions Intermediation class at £100m a year.

## Class threshold for the Investment Intermediation class

4.24 We asked:

*Q14: Do you agree with our proposal to set the class threshold for the Investment Intermediation class at £150m?*

4.25 Many respondents argued that the modelling underestimates the impact of the Retail Distribution Review (RDR) by ignoring the reduction of industry revenue as a result of RDR, and overplays the ‘exceptional’ 2011 peak.

### Our response

We appreciate that the industry is subject to change but also note that FSCS claims in this sector increased steadily in the five years before 2011.

To assess affordability to firms our model used profits (as reported in firms’ regulatory returns) and not revenue. The costs of the RDR (as stated in its cost benefit analysis) were deducted from the profits to arrive at the profits available to industry to pay FSCS levies, which we consider a robust approach.

We acknowledge that the number of advisers will reduce (some estimate by 9-11%) after the RDR<sup>18</sup>, but the extent to which this translates into reduced revenue of the same magnitude is uncertain because:

- The advisers exiting are likely to be of below average size and profitability, and should therefore reduce revenue and profits in the class by less than 9-11%.
- There are likely to be some substitution effects, e.g. customers moving to other advisers and/or advisers selling their client banks.
- Pre-RDR evidence shows that despite a fall in adviser numbers in 2012, 73% of firms maintained or increased revenue in that year.<sup>19</sup>

<sup>18</sup> The CBA for RDR is available at [www.fsa.gov.uk/pubs/policy/ps10\\_06.pdf](http://www.fsa.gov.uk/pubs/policy/ps10_06.pdf).

<sup>19</sup> NMG Consulting (2012), *IFA Census Quarterly trends – September 2012*, Slide 8.

However, we have done some remodelling the results of which do not support this claim.

Our model suggests that the proposed threshold of £150m equates to 25% of industry profits. One respondent suggested that if revenues fall by 10% post RDR, the share would be 40%. However, we have done some remodelling which suggests that the share is more in the region 30%.

If the future funding need in the class is low, the thresholds will not be reached and firms will not be impacted.

Taking account of all the feedback, we have decided to set the threshold of the Investment Intermediation class at £150m.

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## Class threshold for the Home Finance Intermediation class

4.26 We asked:

*Q15: Do you agree with our proposal to set the class threshold for the Home Finance Intermediation class at £40m a year?*

4.27 We only received a very small number of responses to this question, with a slight majority of respondents opposing the proposal.

### Our response

We have not received a rationale in the responses for setting this threshold at a different level and will therefore set the threshold for the Home Finance Intermediation class at £40m a year.

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# 5

## Mitigating volatility

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### Introduction

- 5.1 In this chapter we provide feedback on the responses relating to our proposals in CP12/16 for the assessment of expected compensation costs. This chapter also responds to feedback we received concerning difficulties associated with levy volatility.

### Expected compensation costs proposal

- 5.2 In CP12/16 we acknowledged that the timing of claims and FSCS' funding need can give rise to significant volatility for firms, particularly when those needs must be met from interim levies. We suggested that this may be exacerbated by the misalignment between the 12-month time period over which our rules permit the FSCS to assess its expected compensation costs and the timescales over which compensation costs typically arise as a result of firm failures.
- 5.3 We therefore proposed, except for the Deposits class, that when setting its compensation costs levy, the maximum amount of expected compensation costs the FSCS can include in the annual levy for the separate funding classes<sup>20</sup> will be, subject to the applicable annual class thresholds, the greater of:
- one-third of an aggregate three-year view of expected costs; or
  - costs expected in the 12 months from the date of the levy.
- 5.4 We asked:

*Q17: Do you have any comments on the proposal to extend the period over which expected compensation costs are assessed?*

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<sup>20</sup> Except for the Deposits class.

*Q18: Do you agree that the proposed rule change will deliver the benefits outlined above? If not, do you have any suggestion on how they could be achieved?*

## Feedback to CP12/16

- 5.5 Most respondents understood and appreciated the intended aims of the proposed change: smoothing of levies, greater predictability and fewer interim levies or calls for funding support from other classes. However, many respondents questioned whether the change would, in reality, deliver those benefits. They raised questions about FSCS's ability to accurately forecast claims over a three-year period and sought to better understand:
- the criteria and process by which the FSCS will assess expected compensation costs; and
  - the FSCS's planned process improvements and associated costs.
- 5.6 One respondent put forward an alternative three-year model which it believed would more readily achieve the aims of our proposal. This model was supported by a small number of individual respondents. The two key elements of this proposal<sup>21</sup> are:
- a presumption in favour of borrowing; and
  - a reserve policy (for retaining surpluses), designed to meet exceptional as well as expected expenses.

## Other volatility issues

- 5.7 Use of commercial borrowing as an alternative source of funding featured in many responses to both this and other elements of CP12/16. Conflicting positions emerged, however:
- some favoured the use of borrowing instead of raising interim levies or seeking support from other classes;
  - some were concerned that borrowing might be used to prevent support being drawn from other classes; and
  - others sought a consistent approach to the use of borrowing across all FSCS funding classes.
- 5.8 We made clear in CP12/16 that our proposal would not eliminate the need for interim levies. Many respondents therefore highlighted the elements and challenges of levy volatility that would remain unchanged by our proposal, most notably the cash flow impacts of a requirement to pay unexpected interim levies within 30 days.

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<sup>21</sup> Further detail can be found in the IMA's consultation response which it published on its website.

## Our response

We still consider it desirable and beneficial to introduce our proposed rule change and more closely align the FSCS levying process with a more typical profile of claims. However, in light of feedback, we propose to defer the effective date of the change for one year until 1 April 2014. This will give the FSCS more time to engage with industry in developing an enhanced and cost-effective process for assessing expected costs over the three-year period.

Our proposal acknowledged the potential for surpluses to accrue in-year, but we did not propose that such surpluses could be retained by the FSCS, but that they should be returned to the industry. Typically, the FSCS would use the surplus to offset the expenses 'expected to be incurred' over the next three years (and thereby reduce the next annual levy), though it remains at its discretion to refund the surplus on a reasonable basis.

We cannot consider introducing the Investment Management Association's proposed alternative now as the envisaged reserve policy is akin to pre-funding and is likely to exceed our statutory power to enable the FSCS to impose levies on firms to meet expenses that it expects to incur.<sup>22</sup>

The responses revealed a significant degree of confusion about the level of discretion available to the FSCS to determine how and when to fund compensation costs. Our Handbook rules prescribe how levies must be allocated once the decision has been made to raise them, but there are no explicit rules requiring the FSCS to raise a levy at a particular point in time. We recognise that some of our comments in CP12/16 about the funding sources available to the FSCS have not made things clearer.

So to avoid doubt, we have taken this opportunity to amend the Handbook rules to confirm that:

- the FSCS does, in fact, have discretion to determine when and whether to levy for compensation costs; but
- the FSCS will generally seek to raise a compensation levy in the first instance rather than borrow (or use funds already held for the benefit of other classes) to meet compensation costs; and
- the responsibility for paying the costs of compensating claims once a class exceeds its threshold, cannot be allocated to other funding classes unless the FSCS imposes a compensation levy in respect of those costs. This means that where the FSCS borrows to meet the costs in excess of a class threshold, it is the originating class that will have to meet the costs of borrowing.

The rules also include some guidance suggesting some circumstances when the FSCS may consider it inappropriate to levy the industry. These are examples of when alternative sources of funding might be preferable (in the specific

<sup>22</sup> FSMA s.213(3)(b) – and reflected in the Financial Services Act.

circumstances of a given case): to address short-term liquidity issues, or in order to deal with a significant failure without having to wait for a levy to be raised.

A presumption that the FSCS should use borrowing before triggering contributions from other classes is not impossible legally, but there are some practical limitations to, and policy arguments against, such a presumption (for anything other than providing short-term liquidity), including:

- The FSCS will seek to ensure access to commercial loan facilities. However, these may be yearly facilities, and require repayment within that same term (unlike the National Loans Fund (NLF), repayment of which may be spread over a number of years).
- The terms of the FSCS' syndicated financing facility will be subject to periodic negotiation which means there is no guarantee that such a facility will always be available.
- The FSCS can only borrow if its Directors are comfortable it can repay the amount borrowed before the lending facility expires.
- Any borrowing is likely to be constrained by the annual levy limit.

To provide the industry with further clarity and transparency about the exercise of FSCS's discretion in this area, the FSCS has committed<sup>23</sup> to:

- publishing a statement on its levying policy in summer 2013; and
- taking into account the views of stakeholders, including the FSA (and the PRA/FCA after 1 April 2013), in developing this policy (and any subsequent substantive amendment to it).

We recognise the associated difficulties for firms in absorbing the costs of unpredictable levies on a tight payment schedule but we would expect (and the FSCS intends) to give as much warning as it can when an interim levy is anticipated.<sup>24</sup> But this may not always be possible because the driver for an interim levy could be one of several factors and the FSCS itself may have limited notice.

The FSCS has published some guidance on its website about when it will raise an interim levy.<sup>25</sup> The current MoU between the FSA and the FSCS requires that where interim levies may be necessary, the FSA and FSCS 'will discuss in advance whether the levy has or may have any significant or potentially serious or unforeseen impact on firms'.<sup>26</sup> It is intended that this measure will be expanded in the MoUs between the FSCS and the PRA and FCA respectively with an additional requirement to consider what (if any) action might be reasonably practicable and appropriate to address that impact.

<sup>23</sup> This commitment will be set out under the terms of its Memorandum of Understanding with each of the relevant regulators.

<sup>24</sup> Via close liaison with relevant trade bodies.

<sup>25</sup> [www.fscs.org.uk/industry/funding/levy-information/when-does-fscs-raise-an-interim-levy](http://www.fscs.org.uk/industry/funding/levy-information/when-does-fscs-raise-an-interim-levy)

<sup>26</sup> [www.fsa.gov.uk/pubs/mou/fsafscs.pdf](http://www.fsa.gov.uk/pubs/mou/fsafscs.pdf)

## Levy periods

- 5.9 CP12/16 explained that in practice the FSCS raises levies for compensation costs on the basis of the costs anticipated in the 12-month period from 1 July. This is because the FSCS does not assume the levies are raised before 1 July and has operated on this basis since its inception. However, the corresponding class threshold relates to the financial year (1 April to 31 March). We proposed to make this distinction clear in our rules as this did not appear to be widely understood by the industry.
- 5.10 We asked:

*Q16: Do you agree that we should formalise in our rules the compensation costs levy period (between 1 July and 30 June each year)?*

## Feedback to CP12/16

- 5.11 Most respondents did not answer this question. Most of those who did supported the proposal because it makes things clearer. Those who were less supportive said the compensation costs levy period should be aligned with the FSCS's accounting reference period.

### Our response

We believe that we should amend our Handbook to provide greater clarity on FSCS' current practice. We therefore make it clear that the FSCS will usually levy once in each financial year. In respect of compensation costs this levy will usually be for expenditure expected in the period of 12 months following 1 July in that year. There may still be additional "interim" levies in the course of a financial year.

At this time, aligning the period to the financial year of the FSCS is not practical not least because the FSCS operates on a cash accounting basis. Alignment of the accounting and funding years is something the FSCS may consider in the future. It is likely that any change will be considered as part of a broader discussion, which includes assessing the impact of FSCS reporting under IFRS (International Financial Reporting Standards) including a move to accruals accounting. This change is one which the FSCS is actively considering but the timing for any such move has yet to be determined.

# 6

## Management expenses and minor changes

6.1 In this chapter, we consider issues relating to our proposals regarding FSCS management expenses and other minor changes.

### **Approving the management expenses levy limit (MELL) after legal cutover**

6.2 The MELL limits the amount the FSCS can annually levy for its management expenses. The MELL is made up of specific costs (those relating to a particular default to be paid for by the class to which claims are allocated) and base costs (the FSCS's general costs which are not related to the levels of claims received).

6.3 In CP12/16 we noted our expectation that the MELL would continue to be one limit (as per the Financial Services and Markets Act 2000) after legal cutover. The MELL amount is set under a rule which is currently approved annually by the FSA Board. The requirement to set a MELL will continue after legal cutover and we expect it to be the responsibility of both regulators after 1 April 2013. However, we said we expected the relevant regulator (the PRA or the FCA) to approve aspects of the MELL which came within its remit within the single limit.

6.4 We proposed that specific costs allocated to a particular class would be approved as appropriate by the PRA or FCA. We also proposed splitting the MELL base costs on a 50/50 basis between the PRA and FCA regulatory fee blocks. Each 50% would then be allocated under PRA or FCA rules as appropriate in proportion to their regulatory cost allocation.

6.5 We asked:

*Q.23: Do you agree that the arrangements proposed for approving the MELL post legal cutover are reasonable?*

- 6.6** Most respondents considered our approach as broadly reasonable. However, some asked whether the 50/50 basis would be subject to future review. There was also a concern that PRA firms would pay a higher proportion of base costs than FCA firms and it was instead suggested that we apportion base costs according to firms' relevant income.

### Our response

Base costs are unrelated to the number of claims made on the FSCS and mostly reflect FSCS fixed costs. We recognise that the industry would like us to monitor the division of base costs to ensure the 50/50 split remains appropriate.

The responsibility for base costs is shared by all firms, regardless of who regulates them. This is reflected by the fact that firms will be charged according to regulatory fees paid. We do not think that this will mean that PRA firms will be charged a disproportionately or unreasonably higher proportion of base costs.

As mentioned in CP12/16, the split is broadly in line with the split of costs between the future PRA and FCA fee blocks in recent years.<sup>27</sup> We remain satisfied that the most appropriate method of dividing the base costs is to split them on a 50/50 basis according to the PRA and FCA regulatory fee blocks. So we do not propose to specifically conduct a post-implementation review of base costs, but we will monitor as appropriate.

We note that allocating base costs in this manner would capture minimum fee payers, and this would continue after legal cutover. This will ensure that all firms contribute to the FSCS's base costs (as is current practice).

We have included a transitional provision allowing the FSCS to allocate any surplus or deficit in the balance of an activity group to the account of that activity group as at 1 April 2013 and to take this into account when calculating the amounts for the 2013/14 year. On 1 April 2013, this will reflect that the relevant activity groups are the FCA activity groups.

## Other changes to the MELL

### Thresholds

- 6.7** Currently, thresholds are applied to the levies that can be raised for compensation costs. However, we believe that specific costs (which will continue to form part of the MELL) could impact on the level of funding required. So in CP12/16 we proposed that the threshold

<sup>27</sup> Approximately 50% (in 2011/2012) and 46% (in 2010/2011) of the base costs were met by the fee-blocks which will, in future, be dual regulated: i.e. A1, A3, A4, A5 and A6. A10 (Firms dealing as principal) is not referred to here as the PRA will not be writing rules for investment firms.

currently applying to compensation costs should cover both compensation and specific costs raised by the FSCS annually.

6.8 We asked:

*Q26: Do you agree that the thresholds should apply across both the compensation costs and specific costs raised by the FSCS?*

6.9 All respondents agreed with our proposal to apply the thresholds across both the compensation costs and specific costs raised by the FSCS.

### Our response

We are proceeding with the proposal.

## Interest

6.10 In CP12/16, we proposed amending our rules so that interest costs will be considered a compensation cost.

6.11 We asked:

*Q24: Do you agree we should define interest as a compensation cost rather than specific cost?*

6.12 A minority of respondents misunderstood the type of interest we proposed defining as a compensation cost. To clarify, we meant interest related to any borrowing required to meet claims, for instance the legacy costs interest payments for the 2008 banking defaults. Some respondents also asked whether the class thresholds would be amended due to defining interest as a compensation cost.

6.13 Most respondents agreed with our proposal and felt that it would reduce the potential for the MELL to be distorted by costs which are unrelated to the running of the FSCS.

### Our response

Interest on borrowing to meet claims will only be incurred to fund claims. As such it can appropriately be considered integral to providing compensation and levied as part of the compensation levy.

We have confirmed that the threshold will apply to compensation and specific costs. So the same threshold would apply regardless of whether interest was defined as a compensation or specific cost. The FSCS funding class thresholds themselves were developed based on what was affordable for each class (as covered in Chapter 4).

Therefore, as proposed in CP12/16, interest to meet claims will be part of the compensation costs, rather than a specific cost.

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## Specific costs

**6.14** In CP12/16, we proposed that specific costs must only be attributable to a particular class rather than to a default.

**6.15** We asked:

*Q25: Do you agree that we should make specific costs attributable to a class rather than claims in a particular class?*

**6.16** Most respondents agreed with our proposal to make specific costs attributable to a class rather than claims in a particular class. However, a few respondents suggested determining this on a case-by-case basis. There was also a suggestion that specific costs should remain related to claims to ensure an alignment of responsibility.

### Our response

At present, any specific costs which cannot be attributed to a default are allocated across all classes (irrespective of the origin of the cost). However, we continue to believe that aligning the costs incurred to the class giving rise to the need for the costs is appropriate. This increases alignment rather than reducing responsibility for those costs. By removing reference to default, we are able to give effect to both our intention and the requirements of FSMA. One example of this would be to ensure that future costs relating to the implementation of faster payout for deposit takers would be allocated to deposit takers. On this basis we intend to proceed with our proposal to make specific costs attributable to a class rather than claims in a particular class.

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## Minor changes

- 6.17 In CP12/16, we also proposed some minor changes. These included proposals about the use of funds collected for one class by another, minor amendments to the RMAR, as well as updating a reference to the Bank's repo rate (since implemented by Handbook Administration (No 28) Instrument). We asked the following question:

*Q27: Do you agree that it is reasonable to allow the FSCS to use monies collected for the benefit of one class within the FCA retail pool for the benefit of another in respect of specific costs where it has reasonable grounds to believe that this would be more economical than borrowing funds from a third party or raising a levy?*

- 6.18 Most respondents agreed with our proposal. Some commented that it codified an existing FSCS power, and that reducing the need for additional borrowing would be beneficial. Some agreed subject to satisfactory safeguards and use of a clear and transparent process. A few instead suggested either using regulatory fines or commercial borrowing. There was also a concern that this proposal may result in any surplus not being returned to the originating class.

### Our response

We believe that our proposal remains appropriate. However, the existing rules make it possible for the FSCS to use funds collected for the benefit of one class for compensation costs to be used for other classes. We have decided that this should continue and have also extended this to apply to specific costs.

As a result the FSCS will be able to use monies collected for the benefit of a class (FCA or PRA) for the benefit of any other class (FCA or PRA) for either or both compensation and specific costs. We believe that, with appropriate safeguards, this will make the use of FSCS funding more cost-effective for the generality of firms. As mentioned in Chapter 5 the FSCS has also committed to publishing a statement on its levying policy (including recourse to borrowing).

This is not related to cross-subsidy or spreading the costs of compensation as discussed in Chapter 3. This relates solely to borrowing between classes where levies have already been raised and are held by the FSCS. This is intended to be used for short-term purposes where it is more efficient and economical than raising a levy or borrowing from an external source.

There is no substantive change to the rules which permits the FSCS to refund any surplus, though FEES 6.3.21R has been clarified.

## Miscellaneous

- 6.19 We received a range of general comments in relation to a number of questions asked in CP12/16 which related to the similar topics: compensation limits, the role of the regulator and use of regulatory fines. We have addressed these items below.

### Compensation limits

- 6.20 One respondent to CP12/16 felt that compensation limits were too high relative to other European schemes. Some compensation limits are set by European directive<sup>28</sup>, for example, in respect of deposit takers. So we have limited or no discretion in these areas. We last reviewed compensation limits in CP08/15 and do not plan any stand alone work in this area in the immediate future. It is possible that we will review some of the existing limits to implement directive requirements or as part of broader work on resolution regimes.

### Role and contribution of the regulator

- 6.21 Some respondents felt that past claims resulted from the FSA's failure to supervise firms and products effectively, which CP12/16 fails to address.
- 6.22 Some respondents also questioned whether the threshold increases are necessary given the FCA's stated intention to supervise firms more effectively.

## Our response

The purpose of CP12/16 is to review the funding model of the FSCS. Both the FCA and PRA approach documents<sup>29</sup> to future regulation and supervision have been published and the *Journey to the FCA* in particular has set out the FCA's intention to be more proactive in identifying and addressing conduct issues.

However, neither the FCA nor the PRA will operate a zero-failure regime and the industry should expect firms to fail – indeed one of the PRA's objectives will be to seek to minimise the adverse effect that the failure of a PRA-authorized person could be expected to have on the stability of the UK financial system.<sup>30</sup> In addition we also believe that even the most effective supervisory regime would not be able to eliminate all conduct issues across the financial services industry.

It is important to note that the thresholds represent caps up to which firms can be required to contribute. That means that if the FCA is successful in delivering on its objective of more effective supervision, firms will not be affected.

28 The Deposit Guarantee Schemes Directive (DGSD) (Directive 94/19/EC) and the Investor Compensation Schemes Directive (ICSD) (Directive 97/9/EC).

29 *The PRA's approach to banking supervision* ([www.fsa.gov.uk/static/pubs/other/pr-a-approach-banking.pdf](http://www.fsa.gov.uk/static/pubs/other/pr-a-approach-banking.pdf)), *The PRA's approach to insurance supervision* ([www.fsa.gov.uk/static/pubs/other/pr-a-approach-insurance.pdf](http://www.fsa.gov.uk/static/pubs/other/pr-a-approach-insurance.pdf)) and *The Journey to the FCA* ([www.fsa.gov.uk/static/pubs/other/journey-to-the-fca-standard.pdf](http://www.fsa.gov.uk/static/pubs/other/journey-to-the-fca-standard.pdf))

30 Section 2B of FSMA, as amended by the Financial Services Act 2012.

We also note the provisions of the Financial Services Act 2012 which requires the regulators to investigate and report on possible regulatory failures. A PRA approach document and an FCA Statement of Policy will be published in 2013 on the framework for reporting on regulatory failure.

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## **Use of regulatory fines**

- 6.23** A few respondents to CP12/16 suggested using regulatory fines to reduce levies. One result of the Financial Services Act 2012 is the decision that regulatory fines – which exceed the regulator’s enforcement case costs – will be remitted to the Exchequer.<sup>31</sup>

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<sup>31</sup> [www.legislation.gov.uk/ukpga/2012/21/pdfs/ukpga\\_20120021\\_en.pdf](http://www.legislation.gov.uk/ukpga/2012/21/pdfs/ukpga_20120021_en.pdf)

## Annex 1

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# Cost benefit analysis

1. Section 138I of the Financial Services and Markets Act (FSMA), as amended by the Financial Services Act 2012, requires the FCA to perform a cost benefit analysis (CBA) of proposed rules. We have also performed a CBA for proposed guidance to be issued under section 139A amended FSMA. The FSA has done this in anticipation of the FCA making the changes. The purpose of the CBA is to assess, in quantitative terms where possible and in qualitative terms where not, the economic costs and benefits of a proposed policy.
2. Nearly all of the funding rules contained in the Policy Statement sections of this paper will be adopted and a CBA for these can be found in Annex 1 of CP 12/16. In this section we focus on the CBA for the proposal related to the revised FCA retail pool included in Chapter 3.

### **Baseline**

3. The baseline for this CBA is the rules under which the FSCS currently operates. The proposal on the revised FCA retail pool is expected to affect all firms covered by the FSCS that are members of the FCA FSCS funding classes, as well as any firm also included in the proposed FCA contribution only classes (the deposit acceptors contribution class; the insurers - life contribution class; the insurers – general contribution class; or the home finance providers and administrators contribution class).
4. The effect of the proposal on firms and markets are likely to vary within and across classes. Certain classes may contain firms that are operating in different markets and, vice versa, firms that operate in the same market may be allocated to different classes depending on their permissions to carry out regulated activities. Some firms are active in more than one class.

## Mutual contributions to the FCA retail pool

5. Under the current model, in the event that the compensation costs of any of the FSCS funding classes exceed its annual threshold other (sub) classes have to contribute. The first to be called to contribute will be the corresponding provision or intermediation class within the same broad class from which the costs originated (e.g. General Insurance Provision if the threshold in the General Insurance Intermediation class is reached). If the threshold of this class is reached then all the other classes will have to contribute in proportion to their size. Based on the current class thresholds the total funding available to the FSCS is just over £4bn.
6. The proposal in Chapter 3 on the FCA retail pool will revise how mutual contributions operate:
  - As consulted on in CP 12/16 there will be no mutual contributions to or from any of the classes expected to become PRA classes (i.e. Deposit, General Insurance Provision and Life and Pensions Provision).
  - Support from the FCA retail pool will be available for the classes expected to become the FCA FSCS funding classes via the ‘FCA retail pool’ (i.e. Investment Provision, General Insurance Intermediation, Life and Pension Intermediation, Investment Intermediation and Home Finance Intermediation) for compensation and specific costs. That means that if the compensation costs exceed the annual threshold of an expected FCA class, the other FCA classes will contribute to the additional in proportion to their size and up to their respective threshold.
  - Should the annual threshold of an **intermediation class** be breached, additional support will be available from contributions from the FCA provider contribution classes: the deposit acceptors contribution class; the insurers – life contribution class; the insurers – general contribution class; or the home finance providers and administrators contribution class. The membership and tariff measures of these classes will be based on the future FCA regulatory fee blocks. Each of the FCA contribution classes will also have a threshold applied based on the fees to be paid by firms in the future FCA regulatory fee blocks. As with the FCA FSCS funding classes they will provide support to the FCA retail pool in proportion to their size and up to their respective threshold. The Investment Provision class will only receive support from the other FCA FSCS funding classes and not the FCA provider contribution classes.

## Direct cost to regulators

7. We do not expect these changes to have any material impact on the costs to the FSA<sup>1</sup> and the FSCS as the proposed changes will require certain procedural changes but no substantial infrastructure or systems design costs.

<sup>1</sup> Throughout this CBA references to costs to the FSA will refer to PRA and FCA for proposals coming into effect after legal cutover.

## Costs to firms

### Compliance costs

8. These changes will not give rise to any additional compliance costs for firms as they will not have to take any action to meet the new requirements.

### Compensation Costs

#### *For the classes expected to become PRA classes*

9. The classes expected to become PRA classes will cease to benefit from the availability of funding support from other classes.<sup>2</sup> The CBA for this proposal is contained in CP12/16.

#### *For the classes expected to become FCA classes*

10. The first level of funding support from the corresponding provider or intermediation class within a broad class will no longer be available. Instead, costs in excess of a future FCA FSCS funding class threshold will be levied against the other four expected FCA classes in the FCA retail pool, and, in case of the intermediation classes, the FCA provider contribution classes.
11. If contributions to the FCA retail pool are needed to support, for example, the Investment Intermediation class, this could result in lower costs than at present for the Investment Provision class because the costs will be shared between all FCA FSCS funding classes and FCA provider contribution classes. The FCA provider contribution classes will provide additional support to the pool to fund costs in excess of any of the intermediation class thresholds and will therefore potentially be exposed to costs. However, in order to avoid a disproportionate impact on FCA providers, the firms within the FCA provider contribution classes will not be required to contribute to the pool if the threshold in their corresponding PRA FSCS funding class has already been reached.
12. There is a slight possibility that the FCA retail pool is triggered first but within the same levy year there is a subsequent call on a PRA FSCS funding class that is expected to meet or exceed its threshold. We believe that the risk of this will be low. However, if this scenario arose the FSCS will seek to refund monies already paid by the corresponding FCA provider contribution class. If, for whatever reason this is not possible there is a possibility that firms could be levied up to the maximum threshold of both the PRA FSCS funding class(es) and the FCA provider contribution class(es) within a given year. We expect this to be highly unlikely.
13. It is difficult to estimate how the changes will impact each class (or firm within the class) as it will depend on the size of the cost and the composition and the size of the class. However,

<sup>2</sup> Based on current thresholds this would mean that £535m from the future FCA FSCS classes would not be available to the PRA classes. Also, it would mean that the funding resources of the PRA classes would also not be available between the PRA classes: Deposits £1.84bn; Life and Pensions Provisions £690m; and General Insurance Provision £775m.

for illustrative purposes we present how a £500m compensation demand for the Investment Intermediation class would be distributed among the various classes.

**Table 3: Distribution of £500m compensation costs among the PRA and FCA classes**

Class	Current mutual contribution rules	Proposed revised mutual contribution rules
	<b>Total</b>	
Investment Intermediation	£100m	£150m
Investment Fund Management (Investment Provision)	£270m	£78m
General Insurance Intermediation	£7m	£117m
Life and Pensions intermediation	£4m	£39m
Home Finance Intermediation	£2m	£15m
Deposit	£65m	N/A
General Insurance Provision	£28m	N/A
Life and Pensions Provision	£24m	N/A
<b>FCA Provider Contribution classes</b>	<b>Total</b>	
Deposit acceptors contribution class	N/A	£43m
Home finance providers and administrators contribution class	N/A	£18m
Insurers – general contribution class	N/A	£13m
Insurers – life contribution class	N/A	£27m

NB: Figures are rounded. We are unable to include an estimate of the illustrative rates within each class for the FCA retail pool as we do not have publicly available data for the FCA provider contribution classes. The distribution within these classes will be measured relative to the regulatory fees they will pay to the FCA after legal cutover.

## Market impacts

14. Mutual contributions to the FCA retail pool result in compensation costs to be funded not just by the class in which the costs originated but also by other classes. The spreading of costs might weaken the incentives of firms in the class receiving support from the FCA retail pool to adequately monitor the risk they accumulate, which could potentially distort their risk management systems and the pricing of risk. The size of this effect would depend on how broadly mutual contributions to the FCA retail pool are applied.
15. If the provision of support to the FCA retail pool leads to higher costs in a class, this could cause indirect impacts on markets covered by them. How these impacts materialise will depend on the action that firms will take to meet the higher costs. Firms may pass on an increased levy to customers in the form of higher prices or absorb these costs by narrowing their margins and/or by reducing product diversity and/or quality. Price

increases induced by cost pass-through may impact firms' business volumes.<sup>3</sup> Absorbing rising costs by narrowing margins may affect competition as it may discourage market entry and encourage exit. Any effect of cost-pass through will depend on how much levies will be increased and how predictable and permanent such increases are. Alternatively, firms might decide to absorb the higher compensation cost by lowering their margins or reducing the cost by adjusting their business model and lowering their tariff base.

16. In the case of NLF funding, taxpayers will bear the cost of significant failures than they would otherwise do. However, any monies borrowed would be repaid by the industry in due course.

## Benefits

17. The proposed revised FCA retail pool including the FCA provider contribution classes aims to ensure continued and adequate funding capacity in the face of the volatile and frequent nature of the claims potentially experienced in these classes. It also reduces the risk that a burden may arise for taxpayers.
18. Even though, in contrast to the FCA FSCS funding classes, the FCA provider contribution classes will not be able to receive support from the proposed revised FCA retail pool, *all* FCA classes benefit from an adequately funded FCA retail pool sufficiently large to maintain consumer confidence.
19. In comparison to firms in the expected PRA FSCS funding classes, costs arising from firms in the FCA FSCS funding classes are generally not related to their capital base but, where there has been a breach of a liability by the firm, they are more closely related to the volumes and values of the products they have sold. Moreover, compared to firms in the expected PRA FSCS funding classes, firms in the expected FCA FSCS funding classes fail more frequently.<sup>4</sup> Therefore, high compensation costs may arise that cannot be funded by the individual classes.

## Impact on Mutual Societies

20. Section 138k(2) of the Financial Services Act 2012 amends rule-making powers in the Financial Services and Markets Act, to require the Financial Conduct Authority to provide an opinion on whether the impact of proposed rules on mutual societies is significantly different to the impact of proposed rules on other authorised persons.

<sup>3</sup> The precise impact of the pass-through on the market outcome will depend on factors such as market conditions, ability for price discrimination, elasticity of supply and demand as well as possible economies of scale and scope.

<sup>4</sup> During 2010/11, the FSCS made 207 declarations of default. Though many of these firms were authorised to undertake more than one type of business, 199 of these firms might reasonably be characterised as firms within the future FCA FSCS funding classes. 145 firms were declared in default by the FSCS in 2009/10, 137 of which are likely to have been firms within the future FCA FSCS funding classes.

21. We have confirmed that regulated activities should remain the basis on which:
- all firms, including mutuals, are allocated to funding classes; and
  - compensation and specific costs are allocated to funding classes.
22. This means that the extent to which our proposals will have an impact on any individual mutual, including any redistribution of costs, will depend upon the regulated activities for which they have permission and the level of tariff data they report for these activities each year. In practice, this is no different from the impact our proposals may have on any regulated firm.

## Annex 2

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# Compatibility statement

1. The FSA is consulting on the retail pool rule changes to be made by the FCA. The draft Handbook text includes some changes to FSA rules which are currently intended to be adopted – in identical form – by both the FCA and the PRA on 1st April 2013. However, if the FCA makes the retail pool rule changes, the rules will be different for the PRA and FCA from 1 April 2013.
2. We aim that the FCA rules proposed in Chapter 3 come into effect on that date. We are therefore commenting on the compatibility of our proposals both with the FCA's existing general duties and objectives, and as set out in FSMA as amended by the Financial Services Act 2012. Appropriate editorial amendments may be needed to the draft rules.

### **Compatibility with the FCA's general duties**

3. This paper consults on FCA rules to take effect on 1 April 2013. Accordingly, this section sets out the compatibility of these rules with the FCA's expected general duties, in line with FSMA as amended by the Financial Services Act 2012.

### **Financial Conduct Authority (FCA)**

4. Section 138I(2)(d) of FSMA (as amended by the Financial Services Act 2012) states the consultation undertaken by the FCA must include an explanation of the FCA's reasons for believing that making the proposed rules is compatible with its duties. These are considered below.

*In discharging its general functions the FCA must, so far as is reasonably possible, act in a way which (a) is compatible with its strategic objective, and (b) which advances one or more of its general objectives (section 1B(1) FSMA as amended by the Financial Services Act 2012*

5. The strategic objective of the FCA will be to ensure that the relevant markets function well. The existence of a compensation scheme helps to secure protection for consumers, enabling both consumer confidence and market confidence to be maintained. Financial services firms benefit in general from such confidence. Adequate funding arrangements are central to a well-functioning scheme capable of producing these effects.
6. We consider that our proposals also help ensure that the relevant markets function well in that the proposals where possible ensure that costs are contained within the classes within which they originate.
7. The operational objectives of the FCA are: securing an appropriate degree of protection for consumers; protecting and enhancing the integrity of the UK financial system; and promoting effective competition in the interests of consumers.
8. The existence of a compensation scheme helps to secure protection for consumers. While this is to a large extent provided by section 213(1) of FSMA, which requires a scheme to pay valid claims, the degree of protection depends on the scheme having adequate and reliable funding arrangements that are capable of underpinning the delivery of compensation in a wide range of default scenarios. Once a decision has been made that a consumer is entitled to compensation, this should be supported by adequate funding arrangements.
9. We believe that the proposal for a revised FCA retail pool is appropriate as otherwise we would need to set higher thresholds for the FCA classes to ensure that the scheme is able to cope with potential costs. Without this, consumers may not receive the compensation they are eligible for, and this would seriously damage consumer confidence in the financial system.
10. In terms of enhancing the integrity of the UK financial system any failure on the part of the compensation scheme to make the compensation payments mandated by the scheme rules, because of inadequate funding arrangements, could harm the UK regulatory system and have consequential impacts on the integrity of the market. We judge that the proposal for a revised FCA retail pool will have no or negligible negative impact on the international competitive position of the UK. This advantage will also be offset, to the extent that consumers favour firms that are covered by the scheme. It is possible that some firms might exit the market and passport back into the UK to avoid the perceived potential for higher costs arising in particular from our proposal for mutual contributions to the FCA retail pool. However, we believe that the extent of such exits will be limited and that the associated costs are outweighed by the benefits of our proposals. Also, we would hope that the arrangements proposed will encourage firms to minimise incentives to blur risk management within firms and for the industry to be alert to poor practice.

11. So far as competition between firms in the same class is concerned, if a triggering event occurs – i.e. a need for compensation – all the firms in the same class, that is those competing directly against each other, are treated in the same way. This includes how levies are allocated to firms and the thresholds that apply.
12. This is particularly relevant in respect of firms that are members of classes within the FCA retail pool. In principle, any mutual contributions to the FCA retail pool may have an adverse effect on competition, since it means that some businesses, or set of businesses, will not bear the full costs of its activities. However, mutual contributions are implicit in any industry-funded compensation scheme. Bearing in mind that we regard the potential support provided by the FCA retail pool essential for adequate funding arrangements we have, as noted, sought to minimise any adverse effect on competition by proposing suitable thresholds before such contributions to the FCA retail pool are triggered. This means that in normal years no such support from the FCA retail pool should be necessary.
13. In addition, costs will increase, following a default, for firms in a class. The impact on the firms in any particular class will be the same, because the thresholds have been set at affordable levels. For the scheme to be sustainable it must be affordable to its members: affordability for each class is the key determinant for the thresholds we have set.

*In discharging its general functions the FCA must have regard to the regulatory principles (section 1B(5)(a) FSMA as amended by the Financial Services Act 2012*

14. The regulatory principles of the FCA are stated in section 3B of FSMA as amended by the Financial Services Act 2012, and of those listed the following are relevant to our proposals:

*the need to use the resources of each regulator in the most efficient and economic way:*

15. Our proposal will result in minimal costs to the FSA (FCA after 1 April 2013) and the FSCS.

*the principle that a burden or restriction that is imposed on a person, or on the carrying on of an activity, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction:*

16. We believe that our proposal of a revised FCA retail pool has been designed to strike the right balance between the need to ensure an appropriate level of funding capacity of the scheme while limiting the exposure of particular classes of firm. We believe that by limiting burdens in this way the proposal seeks to secure benefits in a proportionate manner. A cost benefit analysis has also been carried out to support that the proposals are proportionate.

17. Although the provision of compensation should take account of the general principle that consumers should take responsibility for their decisions, this is not directly relevant to establishing adequate funding arrangements for the scheme.

## Annex 3

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# List of questions

**Q1:** Do you have any comments on our proposal?



## Annex 4

# FSCS funding classes and regulated activities

1. Please refer to Fees Sourcebook Chapter 6 Annex 3 for full rules at <http://fsahandbook.info/FSA/html/handbook/FEES/6/Annex3>

Class	Legal basis (i.e. regulated activities)
Deposits	<i>accepting deposits. and/or operating a dormant account fund.</i> BUT does not include any fee payer who either effects or carries out <i>contracts of insurance</i> .
General Insurance Provision	<i>effecting contracts of insurance; and/or carrying out contracts of insurance; that are general insurance contracts.</i>
General Insurance Intermediation	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>
Life and Pensions Provision	<i>effecting contracts of insurance; and/or carrying out contracts of insurance;</i> <i>that are long-term insurance contract (including pure protection contracts).</i>

Class	Legal basis (i.e. regulated activities)
Life and Pensions Intermediation	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>
	<i>agreeing to carry on a regulated activity which is within any of the above;</i>
	in relation to any of the following:
	<i>long-term insurance contracts (including pure protection contracts);</i>
<i>rights under a stakeholder pension scheme or a personal pension scheme.</i>	
Investment Fund Management	Any of the following:
	<i>managing investments;</i>
	<i>establishing, operating or winding up a regulated collective investment scheme;</i>
	<i>establishing, operating or winding up an unregulated collective investment scheme;</i>
	<i>acting as trustee of an authorised unit trust scheme;</i>
	<i>acting as the depositary or sole director of an open-ended investment company;</i>
	<i>establishing, operating or winding up a stakeholder pension scheme;</i>
	<i>establishing, operating or winding up a personal pension scheme;</i>
	<i>agreeing to carry on a regulated activity which is within any of the above.</i>

Class	Legal basis (i.e. regulated activities)
Investment Intermediation	Any of the following activities in relation to <i>designated investment business</i>
	<i>dealing in investments as principal;</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>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> .
Home Finance Provision	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>
Home Finance Intermediation	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 transactions;</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 party);
	<i>agreeing to carry on a regulated activity which is within any of the above.</i>



## Annex 5

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# List of non-confidential respondents to CP12/16

AEGON UK

AXA UK

Abbott Associates Limited

Ace Credit Union Services & UK Credit Unions Ltd

Association of British Credit Unions Ltd

Association of British Insurers

Association of Independent Financial Advisors

Association of Member Directed Pension Schemes

Association of Mortgage Intermediaries

Aviva

Baillie Gifford & Co Ltd

Barclays

Brewin Dolphin

British Bankers' Association

British Insurance Brokers' Association

Chevening Financial Ltd

DPI Financial Services Ltd

David Severn Consulting

Depository and Trustee Association  
E Coleman & Co Ltd  
F&C Asset Management Plc  
Fidelity Worldwide Investment  
Financial Services Consumer Panel  
Financial Services Practitioner Panel  
Frank Dennis  
Granite Financial Services (UK) Limited  
Hargreaves Lansdown  
IFG Management UK Ltd  
Investment Management Association  
Investment and Life Assurance Group  
Killik & Co  
Legal and General Group plc  
Liverpool Victoria Friendly Society  
Lloyd's  
Lloyd's Market Association  
Lloyds Banking Group  
London and International Insurance Brokers' Association  
Managing General Agents Association  
Mcinroy & Wood Ltd  
Myddleton Croft Ltd  
Nationwide Building Society  
Prosperity Wealth Management Limited  
Prudential  
RSA Insurance Group Plc  
Rathbones

SimplyBiz (2)

SimplyBiz Services

Skirrow Insurance Services

Smaller Businesses Practitioner Panel

St James's Place Wealth Management

Tenet Group Limited

The Association of Private Client Investment Managers and Stockbrokers

The Building Societies Association (BBA)

The Share Centre Limited

Vale Asset Management

Wholesale Markets Brokers' Association



## Appendix 1

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# Draft Handbook text

**FINANCIAL SERVICES COMPENSATION SCHEME (FUNDING REVIEW:  
RETAIL POOL) INSTRUMENT 2013**

**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 137T (General supplementary powers);
    - (b) section 139A (Power of the FCA to give guidance);
    - (c) section 213 (The compensation scheme); and
    - (d) section 214 (General);
  - (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 referred to above are specified for the purposes of section 138G (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force on 1 April 2013.

**Amendments to the Handbook**

- D. 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 of definitions	Annex A
Fees manual (FEES)	Annex B

**Citation**

- E. This instrument may be cited as the Financial Services Compensation Scheme (Funding Review: Retail Pool) Instrument 2013.

By order of the Board  
[date]

## Annex A

## Amendments to the Glossary of definitions

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

*FCA provider contribution class* a class to which the FSCS may only allocate a *compensation costs levy* or *specific costs levy* allocated to the *retail pool*, as described in FEES 6.5A, namely: the deposit acceptor's *contribution class*; the insurers - life *contribution class*; the insurers - general *contribution class*; or the home finance providers and administrators' *contribution class*.

Amend the following definitions as shown.

*class* ...

(5) (in FEES) one of the broad classes to which FSCS allocates levies as described in ~~FEES 6.5.7R~~ 6.4.7R, FEES 6.5.6R and FEES 6 Annex 3R.

*levy limit* (in FEES) the maximum aggregate amount of *compensation costs* and *specific costs* that may be allocated to a particular *class* in one financial year as set out in FEES 6 Annex 2R, whether directly or (where relevant to that class) through the retail pool. FCA provider contribution classes do not have a levy limit: they have a retail pool levy limit: see FEES 6 Annex 5R.

## Annex B

## Amendments to the Fees manual (FEES)

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

## 6 Financial Services Compensation Scheme Funding

### 6.1 Application

...

General structure

...

- 6.1.7 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 ~~eight~~ twelve 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 intermediation class*; ~~and~~ 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. The *permissions* held by a *participant firm* determine into which *class*, or *classes*, it falls.

...

The management expenses levy

...

- 6.1.11 G ...When the *FSCS* imposes a *specific costs levy*, the levy is allocated to the *class* which is responsible for 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 retail pool

- 6.1.16A G ~~{deleted}~~ The *FCA* has made *rules* providing that *compensation costs* and *specific costs* attributable to the *intermediation classes* and the *investment provision class*, 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). 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 on *regulatory costs* (see *FEES 6.5A.6R*).

...

## 6.2 Exemption

- 6.2.1 R (1) A 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* and has no reasonable likelihood of doing so is exempt from a *specific costs levy*, or a *compensation costs levy*, or both, provided that:
- (2) ...
- (3) The exemption in (1) does not apply in respect of a *specific costs levy* or *compensation costs levy* arising from the firm's membership of an *FCA provider contribution class*.

...

## 6.4 Management expenses

...

Specific costs levy

- 6.4.6 R The *FSCS* must allocate any *specific costs levy*:
- (1) first, amongst the relevant *classes* in proportion to the amount of relevant costs arising from the different activities for which *firms* in those *classes* have *permission* up to the *levy limit* of each relevant *class*. The *FCA provider contribution classes* are not relevant *classes* for this purpose.
- (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 5R*), to the *retail pool*, in accordance with and subject to *FEES 6.5A*.
- 6.4.7 R The *FSCS* must calculate a *participant firm's* share of a *specific costs levy* (subject to *FEES 6.3.22R* (Adjustments to calculation of levy shares) by:
- ...
- (3) calculating, in relation to each relevant *class*, the *participant firm's* tariff base (see *FEES 6 Annex 3R*) 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);

...

...

## 6.5 Compensation costs

...

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

- (1) first, to the relevant classes in proportion to the amount of *compensation costs* arising from, or expected to arise from, claims in respect of the different activities for which *firms* in those *classes* have *permission* up to the *levy limit* of each relevant *class*. The *FCA provider contribution classes* are not relevant classes for this purpose; and
- (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 5R), to the *retail pool*, in accordance with, and subject to, *FEES* 6.5A.

...

6.5.6 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:

- (1) identifying each of the relevant classes to which each *participant firm* belongs, using the statement of business most recently supplied under *FEES* 6.5.13R(1);

...

- (3) calculating, in relation to each relevant *class*, the *participant firm's* tariff base (see *FEES* 6 Annex 3R) 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

- 6.5.7 R ~~When calculating a *participant firm's* share of a *compensation costs levy* or *specific costs levy* allocated to each *class* the *FSCS* must use the *classes* and tariff bases as set out in the table in *FEES 6 Annex 3R*. [deleted]~~

...

Insert the following sub-chapter after FEES 6.5. The new text is not underlined.

### 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 6.5.2R(2)*):

- (1) to *classes*:
  - (a) whose *retail pool* levy limit has not been reached as at the date of the levy; and
  - (b) (for *FCA provider contribution classes* other than the home finance providers and administrators' contribution class) where the *levy limit* of the corresponding *PRA funding class* (see *FEES 6.5A.7R*) has also not been reached as at the date of the levy;
- (2) in proportion to the relative sizes of the *retail pool* levy limits of the *classes* in (1); and
- (3) in accordance with the table in *FEES 6 Annex 5R*.

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

- 6.5A.2 R (1) Where:
- (a) an *FCA provider contribution class* has already contributed to *specific costs* or *compensation costs* (through the *retail pool*); and
  - (b) if the amount of that previous contribution were added to a *compensation costs levy* or *specific costs levy* which is being imposed on the corresponding *PRA funding class* (and any previous such levies) as set out in *FEES 6.5A.7R*,

the combined figure would be greater than the *levy limit* of the corresponding *PRA funding class*;

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

- (2) The *FSCS* may obtain the repayment in (1) by:
- (a) a levy;
  - (b) commercial or other borrowing; or
  - (c) utilising funds as set out in, and subject to, *FEES* 6.3.17R.

[**Note:** the home finance providers and administrators' contribution *class* does not have a corresponding *PRA funding class*.]

- 6.5A.3 G In considering which of the options in *FEES* 6.5A.2R(2) to adopt, the *FSCS* will generally impose a levy, rather than borrow or utilise funds as described in *FEES* 6.5A.2R(2)(c), unless the latter options appear to be preferable in the specific circumstances prevailing at the relevant time.
- 6.5A.4 R The calculation of the relative sizes of the *retail pool* levy limit (for the purpose of *FEES* 6.5A.1R) is based on the original *retail pool* levy limits for the *classes* (as set out in *FEES* 6 Annex 5R) and not the remaining capacity in each *class*.
- 6.5A.5 R When the *FSCS* allocates excess *compensation costs levies* or *specific costs levies* under *FEES* 6.5A.1R, a *class* to which part of the excess is allocated (a "receiving class") may, as a result of that allocation, itself reach its limit. In that case, the *FSCS* must apply *FEES* 6.5A.1R so that any resulting excess levy beyond the limit of the receiving class is allocated amongst the remaining *classes* whose limits have not been reached, to the exclusion of the receiving *class*. This process is repeated until the *compensation costs levy* or *specific costs levy* has been met in full or the limits of all *classes* have been exhausted.

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* 6.4.7R (3) and *FEES* 6.5.6R(3), respectively, are replaced by the following: "calculating, in relation to each relevant *class*, the *participant firm's regulatory costs* arising from its membership of the corresponding activity group (as listed in *FEES* 4 Annex 1R) set out in *FEES* 6.5A.7R,

as a proportion of the total *regulatory costs* of all *participant firms* in that activity group arising from their membership of that group;”.

- 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:

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

Amend the following text as shown.

**6 Annex Financial Services Compensation Scheme - classes  
3R**

This table belongs to *FEES 6.5.7R* *6.4.7R* and *FEES 6.5.6R*

...

<b>Class E</b>	<b>Home Finance</b>
...	
<b>Tariff base</b>	...
	Class: E2: <i>annual eligible income</i> where the annual income is calculated in accordance with fee-block A18 in part 2 of <i>FEES 4 Annex 1R</i> .
<b><u>Class F</u></b>	<b><u>Deposit acceptor’s contribution</u></b>
<b><u>Firms with permission for:</u></b>	<u><i>accepting deposits</i> and/or <i>operating a dormant account fund</i>. BUT does not include any fee payer who either effects or</u>

	<u>carries out contracts of insurance.</u>
<b><u>Class G</u></b>	<b><u>Insurers – life contribution</u></b>
<b><u>Firms with permission for:</u></b>	<u>effecting contracts of insurance; and/or</u>
	<u>carrying out contracts of insurance;</u>
	<u>in respect of specified investments that are:</u> - <u>general insurance contracts; or</u> - <u>long-term insurance contracts other than life policies.</u>
<b><u>Class H</u></b>	<b><u>Insurers – general contribution</u></b>
<b><u>Firms with permission for:</u></b>	<u>effecting contracts of insurance; and/or</u>
	<u>carrying out contracts of insurance;</u>
	<u>in respect of specified investments that are:</u> - <u>general insurance contracts; or</u> - <u>long-term insurance contracts other than life policies.</u>
<b><u>Class I</u></b>	<b><u>Home finance provision</u></b>
<b><u>Firms with permission for:</u></b>	<u>Any of the activities below</u>
	<u>entering into a home finance transaction;</u>
	<u>administering a home finance transaction;</u>
	<u>agreeing to carry on a regulated activity which is within any of the above.</u>

<b>Notes</b>	
...	
(4) For classes G to I (inclusive) the tariff base is not set out in this Annex: see <u>FEES 6.4.7R(3), FEES 6.5.6R(3) and FEES 6.5A.6R</u>	

Insert the following after *FEES* 6 Annex 4G. The new text is not underlined.

### **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 <i>investment provision class</i> . <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> ]			
Deposit acceptors contribution	No	110	Yes (except for costs attributable to the investment provision class)
Insurance – life contribution		70	
Insurance – general contribution		35	
Home finance providers and administrators' contribution		45	
<b>Classes that both contribute to and are funded by the retail pool</b>			
[Note: A <i>compensation costs levy</i> or <i>specific costs levy</i> , in respect of costs attributable to these <i>classes</i> in excess of their <i>levy limits</i> , must be allocated to the <i>retail pool</i> . A <i>compensation costs levy</i> or <i>specific costs levy</i> allocated to the <i>retail pool</i> is then allocated to all other <i>classes</i> contributing to the <i>retail pool</i> (up to each <i>class's retail pool</i> contribution limit), except as specified below for the <i>investment provision class</i> .]			
Investment provision	Yes, under <i>FEES 6.5.2R(2)</i> (but costs attributable to the investment provision <i>class</i> cannot be allocated to the <i>FCA provider contribution classes</i> )	<i>Class levy limit</i>	Yes
Life and pensions intermediation			
Home finance intermediation			
Investment intermediation			
General insurance intermediation			



## Appendix 2

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# Designation of Handbook Provisions

FSA Handbook provisions will be ‘designated’ to create a FCA Handbook and a PRA Handbook on the date that the regulators exercise their legal powers to do so. Please visit our website<sup>1</sup> for further details about this process.

We plan to designate the Handbook Provisions which we are proposing to create and/or amend within Chapter 3 of this Consultation Paper as follows. These designations are draft and are subject to change before the new regulators begin exercising their legal powers.

All the amendments to the Handbook Provisions and the new Provisions which we are proposing to create will be made only by the FCA.

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<sup>1</sup> One-minute guide <http://media.fsahandbook.info/latestNews/One-minute%20guide.pdf>



## Appendix 3

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# Made rules (legal instrument)

**FINANCIAL SERVICES COMPENSATION SCHEME (FUNDING REVIEW)  
INSTRUMENT 2013**

**Powers exercised**

- A. The Financial Services 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 156 (General supplementary powers);
    - (b) section 157(1) (Guidance);
    - (c) section 213 (The compensation scheme);
    - (d) section 214 (General); and
    - (e) section 223 (Management expenses); 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 referred to above are specified for the purposes of section 153(2) (Rule-making instruments) of the Act.

**Commencement**

- C. (1) Part 2 of Annex B to this instrument comes into force on 1 April 2014.
- (2) The remainder of this instrument comes into force on 1 April 2013.

**Amendments to the Handbook**

- D. The modules of the FSA’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 of definitions	Annex A
Fees manual (FEES)	Annex B
Supervision manual (SUP)	Annex C
Dispute Resolution: Complaints sourcebook (DISP)	Annex D
Compensation sourcebook (COMP)	Annex E

**Citation**

- E. This instrument may be cited as the Financial Services Compensation Scheme (Funding Review) Instrument 2013.

By order of the Board  
17 January 2013

## 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 definition in the appropriate alphabetical position. The text is not underlined.

*retail pool*                      the pool of *classes* to which the *FSCS* allocates levies as described in *FEES* 6.5A [to follow].

Delete the following definition.

~~*sub-class*                      one of the classes of *participant firms* within a *class* set out in *FEES* 6 Annex 3 R being sub-classes that carry on business of a similar nature or have other common characteristics, to which *compensation costs* and *specific costs* are allocated in accordance with *FEES* 6.4 and *FEES* 6.5. Class A (Deposits) is to be treated as being made up of a single *sub-class*.~~

Amend the following definitions as shown.

*annual eligible income*      (in *FEES*) (in relation to a *firm* and a ~~*sub-class*~~) the annual income (as described in *FEES* 6 Annex 3R) for the *firm's* last financial year ended in the year to 31 December preceding the date for submission of the information under *FEES* 6.5.13R attributable to that ~~*sub-class*~~. A *firm* must calculate *annual eligible income* from such annual income in one of the following ways:

...

*base costs*                      ~~*management expenses, other than establishment costs,* which are not dependent on the level of *claims* made on the *FSCS* attributable to any particular class.~~

*class*                                      ...

(5) (in *FEES*) one of the ~~broad~~ classes to which *FSCS* allocates levies as described in *FEES* 6.5.7R.

*compensation costs*              the costs incurred:

...

(e) by virtue of section 61 (Sources of compensation) of the Banking Act 2009;

(including the costs of paying interest, principal and other costs of borrowing to pay such costs).

*levy limit*

(in *FEES*) the maximum aggregate amount of *compensation costs* and *specific costs* that may be allocated to a particular ~~*sub-class*~~ or *class* in one financial year as set out in *FEES* 6 Annex 2R.

## Annex B

### Amendments to the Fees manual (FEES)

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

#### **Part 1: Comes into force on 1 April 2013**

### **6 Financial Services Compensation Scheme Funding**

#### **6.1 Application**

...

##### General structure

- 6.1.4 G Section 213(3)(b) of the *Act* requires the *FSA* to make *rules* to enable the *FSCS* to impose levies on *authorised persons* in order to meet its expenses. These expenses include in particular expenses incurred, or expected to be incurred, in paying compensation, borrowing or insuring risks.
- 6.1.4A G Section 224F of the *Act* enables the *FSA* to make *rules* to enable the *FSCS* to impose levies on *authorised persons* (or any class of *authorised persons*) in order to meet its management expenses incurred if, under Part 15A of the *Act*, it is required by HM Treasury to act in relation to *relevant schemes*. But those *rules* must provide that the *FSCS* can impose a levy only if the *FSCS* has tried its best to obtain reimbursement of those expenses from the *manager of the relevant scheme*.
- 6.1.5 G The *FSCS* may impose three types of levy: a *management expenses levy* (consisting of a *base costs levy* and a *specific costs levy*), a *compensation costs levy* and a *MERS levy*. The *FSCS* has discretion as to the amount and timing of the levies imposed.
- 6.1.6 G In calculating a *compensation costs levy*, the *FSCS* may include ~~anticipated compensation costs for defaults expected to be determined~~ in the 12-month period following the date of the levy. The total amount of all *management expenses levies* attributable to a financial year ~~will be restricted to~~ may not exceed the amount set out on an annual basis in *FEES 6 Annex 1R*.
- 6.1.7 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 ~~five~~ eight *classes*: the ~~deposit~~ 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~~ intermediation *class* and the general insurance intermediation *class*. The ~~business carried on~~ permissions held by a *participant firm*

determines determine into which *class*, or *classes*, it falls.

- 6.1.8 G ~~Within each *class* there are one or more *sub-classes*. These relate to different types of activity carried on by *participant firms* within each *class*. Within a *class*, individual *participant firms* are allocated for funding purposes to one or more *sub-classes*, depending on their business activities. This, together with the The provisions on the allocation of levies to *sub-classes* up to their *levy limits*, ~~meets~~ meet a requirement of section 213(5) of the *Act* that the *FSA*, 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 deposit *class* is made up of a single *sub-class*. This means that a reference to a *sub-class* will, unless the context otherwise requires, include a reference to the *deposits class*.~~~~

The management expenses levy

...

- 6.1.10 G A *management expenses levy* ~~under *COMP*~~ may consist of two elements. The first is a *base costs levy*, for the base costs of running the *compensation scheme* in a financial year, that is, costs which are not dependent upon the level of activity of the *compensation scheme* and which therefore are not ~~referable~~ attributable to any specific ~~default~~ class.

...

- 6.1.11 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. These costs ~~depend on the number of claims and types of default~~ are attributable to a class, and include the ~~salaries~~ salary costs of the certain staff of the *FSCS* and claims handling and legal and other professional fees ~~paid in respect of particular defaults~~. 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 *sub-class* (but below the *levy limit* for that *sub-class* for the year) ~~or the cost of commercial borrowing to allow *FSCS* to pay claims attributable to a particular *sub-class* in advance of the next levy. Where a *levy limit* has been reached and *FSCS* secures borrowing in order to pay claims allocated to another *sub-class* in accordance with the rules on allocation in *FEES* 6.5.2R, the costs of borrowing are attributable to the *sub-class* whose *levy limit* has been reached. The specific costs *specific costs* are allocated attributed to the *sub-class* which is responsible for those costs ~~under *COMP*, on the basis of the *protected claims* against that *person*. When the *FSCS* imposes a *specific costs levy*, the levy is allocated to the *class* which is responsible for those costs up to the relevant *levy limits*. The *FSCS* may include in a *specific costs levy* the specific costs *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 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 *sub-classes* to which the *FSCS* has allocated ~~specific costs~~ specific costs. Each *sub-class* has a separate "tariff base" for this purpose, set out in *FEES* 6 Annex 3R. *Participant firms* may be exempt from contributing to the *specific costs levy*.

...

The compensation costs levy

- 6.1.14 G ~~The In imposing a compensation costs levy in each financial year of the compensation scheme is made up of the FSCS~~ will take into account the *compensation costs* which the *FSCS* has incurred and has not yet recovered from *participant firms* raised through levies, (less any recoveries it has made using the rights that have been assigned to it or to which it is subrogated), together with and those *compensation costs* it expects to incur (including in respect of defaults yet to be declared) over the 12 months following the date of the levy.
- 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
  - (2) in safeguarding *eligible claimants* when insurers are in financial difficulties; or
  - (3) in making payments or giving indemnities under *COMP* 11.2.3R and; or
  - (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 the costs. For funding purposes, When the *FSCS* imposes a *compensation costs levy* these costs are allocated by the *FSCS*, and met by *participant firms*, in the same way as *specific costs* the levy is allocated to the class which is responsible for the costs up to relevant *levy limits* and then in accordance with the allocation provisions in ~~*FEES* 6.5.2R~~. 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 *sub-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~~ *firm* in respect of each of the *sub-classes* for that year. Each *sub-class* has a *levy limit* which is the maximum amount of *compensation costs* and

*specific costs* which may be allocated to a particular *sub-class* in a financial year for the purposes of a levy. ~~Once the costs attributable to a particular *sub-class* have exceeded the *levy limit* the excess costs are allocated to the other *sub-class* in the same *class*, up to the *levy limit* of that other *sub-class*, and thereafter allocated to a 'general retail pool' of all the other *sub-classes* whose *levy limits* have not been reached (with the exception of the home finance providers). The amount of the excess cost to be allocated to each particular *sub-class* in the general retail pool is calculated pro-rata in accordance with the relative size of the *levy limit* of that *sub-class* to the sum of the *levy limits* of the remainder of the *sub-classes* in the general retail pool whose *levy limits* have not been reached. In the case of the deposits *class*, once the costs attributable to that class have exceeded the *levy limit* the excess costs are allocated to the general retail pool. The use made by FSCS of borrowing facilities to provide liquidity until the next levy does not affect this allocation of costs.~~

- 6.1.16A G ~~FSCS may consider obtaining insurance cover, if available, against the risk that the value of claims FSCS pays out exceeds the *levy limits* of, or given levels within, particular *classes*. Any costs associated with the insurance would be allocated proportionally to the *classes* intended to benefit from that insurance. [deleted]~~

Incoming EEA firms

- 6.1.17 G *Incoming EEA firms* which obtain cover or 'top up' under the provisions of COMP 14 are firms whose *Home State* scheme provides no or limited compensation cover in the event that they are determined to be in default. Under FEES 6.6, the FSCS is required to consider whether *incoming EEA firms* should receive a discount on the amount that they would otherwise pay as their share of the levy, to take account of the availability of their *Home State* cover. The amount of any discount is recoverable from the other members of the *incoming EEA firm's sub-class*.

...

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

~~General limits on 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* or 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 expenditure already incurred, actual and expected recoveries and:
- (1) in the case of a *management expenses levy*, the level of the FSCS's ~~anticipated~~ expected expenditure in respect of those expenses in the financial year of the *compensation scheme* in relation to which the levy is imposed; ~~and~~

- (2) in the case of a *compensation costs levy*, the level of the *FSCS's anticipated expected* expenditure in respect of *compensation costs* in the 12 months immediately following the levy.

...

- 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 period of 12 months following 1 July in that 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, do one or more of the following:
- (1) impose an interim *compensation costs levy* or *management expenses levy*; or
  - (2) utilise other sources of funding such as commercial borrowing or other borrowing including from the National Loans Fund; or
  - (3) utilise money collected from *firms* as set out in, and subject to, *FEES* 6.3.17R (Management of funds).

The *FSCS* will generally impose a levy rather than borrow or utilise funds as described in (3), unless the latter options appear to it to be preferable in the specific circumstances prevailing at the relevant time; for example, to address short-term liquidity issues, or in order to deal with a significant failure without having to wait for a levy to be imposed or collected.

- 6.3.3 G ~~The *FSCS* may impose one or more levies in a financial year to meet its *management expenses*, its *compensation costs* or its *management expenses* in respect of *relevant schemes*. The *FSCS* may also impose interim levies, as part of its overall levy commitment. This flexibility allows the *FSCS* to phase its financing over the course of a financial year and thus avoid collecting levies from firms before the money is actually needed. The *FSCS* has committed itself in the Memorandum of Understanding with the *FSA* (the text of which can be found on the *FSA* website [www.fsa.gov.uk](http://www.fsa.gov.uk)) to publish regularly an indicative timetable for its levy procedures and its policy in respect of levying.~~

...

#### Imposing a MERS levy

- 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.

Limits on compensation costs and specific costs levies on ~~sub-classes and~~

classes

- 6.3.5 R The maximum aggregate amount of *compensation costs* and *specific costs* for which the *FSCS* can levy each ~~sub-class~~ and *class* in any one financial year of the *compensation scheme* is limited to the amounts set out in the table in *FEES* 6 Annex 2R.

...

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* and ~~relevant sub-classes~~, in accordance with the allocation established under *FEES* 6.4.6R and *FEES* 6.5.2R.

...

- 6.3.13 R Interest earned by the *FSCS* in the management of funds held to the credit of a ~~sub-class~~ must be credited to that ~~sub-class~~, and must be set off against the *management expenses* or *compensation costs* allocated to that ~~sub-class~~.

- 6.3.14 R The *FSCS* must keep accounts which ~~show~~ include:
- (1) the funds held to the credit of each *class* and ~~relevant sub-class~~; and
  - (2) the liabilities of that *class* and ~~relevant sub-class~~.

- 6.3.15 R ~~The *FSCS* may use the money collected from *firms* within one *class* to pay *compensation costs* in respect of any *sub-class* within that *class* so long as it ensures that this is done without prejudice to the *participant firms* from whom the money has been collected. [deleted]~~

- 6.3.15A G ~~*FEES* 6.3.15R deals with how the *FSCS* may use money available to it and does not affect the *rules* on allocation in *FEES* 6.5.2R. Therefore the requirement that the procedure in *FEES* 6.3.15R should not prejudice the *participant firms* does not apply to an allocation under *FEES* 6.5.2R. [deleted]~~

- 6.3.16 G *FEES* 6.3.15R means that, for example:
- (1) when crediting interest under *FEES* 6.3.13 R, the *FSCS* should regard any money collected from one ~~sub-class~~ which has been used to pay the *compensation costs* of another ~~sub-class~~ within the same *class* as standing to the credit of the first ~~sub-class~~;
  - (2) the *FSCS* should not raise a levy under *FEES* 6.3.1R on a ~~sub-class~~ solely because, as a result of the *FSCS's* action under *FEES* 6.3.15R, there appear to be insufficient funds available to the credit of the ~~sub-class~~ to meet its expenses; and

- (3) ~~(2) would not be applicable to the extent that the funds used are in respect of costs allocated to the *sub-class* in accordance with the rules on allocation in FEES 6.5.2 R(1) and (2). [deleted]~~
- 6.3.17 R (1) The *FSCS* may use any money held to the credit of one *class* (the creditor *class*) to pay ~~compensation costs~~ compensation costs or specific costs in respect of attributable or allocated by way of levy to another *class* (the debtor *class*) if the *FSCS* has reasonable grounds to believe that this would be more economical than borrowing funds from a third party or raising a levy.
- (2) Where the *FSCS* acts in accordance with (1), it must ensure that:
- ...
- (c) the amount lent by the creditor *class* to the debtor *class* is taken into account by the *FSCS* when considering whether to impose a ~~compensation costs levy~~ compensation costs levy on the creditor *class* under FEES 6.3.1R.
- 6.3.18 G FEES 6.3.17R deals with how *FSCS* may use money already available to it and does not affect the rules on levy allocation in FEES ~~6.5.2R~~ 6.4, 6.5 and 6.5A. ~~Therefore FEES 6.3.17R(2)(a), (b) and (c) do not apply where the costs otherwise attributable to one debtor *class* are allocated to the creditor *class* in accordance with the rules on allocation in FEES 6.5.2R.~~
- 6.3.19 R Unless FEES 6.3.20R applies, any recoveries made by the *FSCS* in relation to *protected claims* must be credited to the ~~*sub-classes*~~ to which the related *compensation costs* were allocated was attributable.
- 6.3.20 R (1) ~~This rule applies where~~ Where the *FSCS* makes recoveries in relation to *protected claims* where a related *compensation costs* levy would have been ~~met by~~ allocated to a *sub-class* (sub-class A) had the *levy limit* for sub-class A not been reached and have therefore been met by has been allocated to another *sub-class* or *sub-classes* in the retail pool, the recoveries must be applied:
- (a) first, to the *classes* to which the costs levied were allocated in accordance with FEES 6.5A in the same proportion as those *classes* contributed, up to the total amount of that allocation plus interest at a rate equivalent to the Bank of England's Official Bank Rate from time to time in force; and
- (b) thereafter, to class A.
- (2) This *rule* applies even though the recovery is made in a subsequent financial year.
- (3) ~~Recoveries referred to in (1) must be applied in the following order of priority:~~

- (a) ~~(if the *compensation costs* were allocated to the general retail pool (see *FEES 6.5.2 R(2)*) to the *classes* and *sub-classes* to which the costs were allocated in accordance *FEES 6.5.2 R(2)* in the same proportion as those *classes* and respective *sub-classes* contributed, up to the total amount of that allocation plus interest at a rate equivalent to the Bank of England's repo rate from time to time in force;~~
- (b) ~~(if the *compensation costs* were allocated to the other *sub-class* in the same *class* as sub-class A) to that other *sub-class* up to the total amount of that allocation plus interest at a rate equivalent to the Bank of England's repo rate from time to time in force; and~~
- (c) ~~sub-class A. [deleted]~~

...

- 6.3.21 R If the *FSCS* has more funds (whether from levies, recoveries or otherwise) to the credit of a *sub-class* than the *FSCS* believes will be required to meet levies on that *sub-class* for the next 12 *months* it may refund the surplus to members or former members of the *sub-class* on any reasonable basis.

...

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:
    - (i) A acquires all or a part of the business of another *firm* (B), whether by merger, acquisition of goodwill or otherwise; or
    - (ii) A became authorised as a result of B's simple change of legal status (as defined in *FEES 3 Annex 1R Part 6*);
  - (b) B is no longer liable to pay a levy; and
  - (c) that acquisition or change takes place after the date to which, or as of which, A's most recent statement of business under *FEES 6.5.13R* is drawn up so far as concerns the *sub-classes* covered by B's business.
- (2) A must pay an additional amount equal to the levy that would have been payable by B in relation to the relevant business and relevant *sub-classes* if the acquisition or change in status had not taken place and B had remained liable to pay levies. The amount is based on the most recent information supplied by B under *FEES 6.5.13R*. A is included in the *sub-classes* applicable to the relevant business.

...

...

## 6.4 Management expenses

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### Base costs levy

- 6.4.5 R ~~Unless Subject to FEES 6.3.22R applies,~~ 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 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 1R); and
    - (b) allocating 50% of those *base costs* as the sum to be levied on participants in all the activity groups listed in FEES 4 Annex 1R;
  - (2) calculating the amount of the *participant firm's regulatory costs* as a proportion of the total *regulatory costs* relating to all *participant firms* for the relevant financial year; ~~and:~~
    - (a) if the *participant firm* belongs to any of the activity groups in (1)(a), imposed by the FSA in respect of those groups; and
    - (b) if the *participant firm* belongs to any of the activity groups in (1)(b), imposed by the FSA in respect of those groups; and
  - (3) applying the proportion calculated in (2)(a) (if any) to the ~~figure~~ 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.

### Specific costs levy

- 6.4.6 R The FSCS must allocate any *specific costs levy* amongst the relevant ~~*sub-classes*~~ in proportion to the amount of relevant costs ~~arising from, or expected to arise from, claims in respect of~~ arising from the different activities ~~represented by~~ for which *firms* in those *sub-classes* have permission up to the *levy limit* of each relevant *class*.

- 6.4.7 R The *FSCS* must calculate a *participant firm's* share of a *specific costs levy* (subject to *FEES* 6.3.22R (Adjustments to calculation of levy shares) by:
- (1) identifying each of the relevant *sub-classes* to which the *participant firm* belongs, using the statement of business most recently supplied under *FEES* 6.5.13R;
  - (2) identifying the *management expenses* other than *base costs* which the *FSCS* has incurred, or expects to incur, in the relevant financial year of the *compensation scheme*, allocated to the *sub-classes* identified in (1), but not yet levied;
  - (3) calculating, in relation to each relevant *sub-class*, the *participant firm's* tariff base as a proportion of the total tariff base of all *participant firms* in the *sub-class*, using the statement of business most recently supplied under *FEES* 6.5.13R;
  - (4) applying the proportion calculated in (3) to the figure in (2); and
  - (5) if more than one *class* ~~or *sub-class*~~ is relevant, adding together the figure in (4) for each *sub-class*.

...

- 6.4.10A R (1) This *rule* deals with the calculation of:
- ...
- (c) the tariff base for the ~~*class* or *sub-classes*~~ *classes* that relate to the relevant *permissions* or extensions, as the case may be.

...

...

## 6.5 Compensation costs

- 6.5.1 R ~~The *compensation costs levy* is made up of *compensation costs* incurred by the *FSCS*, together with any *compensation costs* expected to be incurred in the 12 *months* following the levy date, and which in each case have not already been subject to a levy. [deleted]~~
- 6.5.2 R The *FSCS* must allocate any *compensation costs levy* ~~to the *sub-classes* in proportion to the amount of *compensation costs* arising from, or expected to arise from, claims in respect of the different activities represented by those *sub-classes* up to the *levy limit* of each relevant *sub-class* and thereafter in the following order:~~
- (1) ~~any excess must be allocated to the other *sub-class* in the same *class* up to the *levy limit* of that other *sub-class* (except in the deposit *class*, for which there is only one *sub-class*); and any excess must be allocated to the other *sub-class* in the same *class* up to the *levy limit*~~

of that other *sub-class* (except in the *deposit class*, for which there is only one *sub-class*) first, to the *classes* in proportion to the amount of *compensation costs* arising from, or expected to arise from, claims in respect of the different activities for which *firms* in those *classes* have *permission* up to the *levy limit* of each relevant *class*; and

- (2) ~~any excess above the *levy limit* of the *class* must be allocated to each other *sub-class*, other than the home finance provision *sub-class* E1, whose *levy limit* has not been reached (the 'general retail pool'), in proportion to the relative sizes of the *levy limits* of those remaining *sub-classes* in the general retail pool 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*, to the *retail pool* in accordance with FEES 6.5A.~~

- 6.5.2A G The use made by FSCS of borrowing facilities to provide liquidity until the next levy does not affect the attribution of *compensation costs*, nor the allocation of costs incurred or anticipated *compensation cost levies*; the allocation of a *compensation costs levy* occurs at the time that the FSCS imposes a levy.
- 6.5.2B G The calculation of the relative sizes of the *levy limits* for the purpose of ~~FEES 6.5.2R(2) (including any allocations caused by the exhaustion of a receiving *sub-class*) is based on the original *levy limit* for the *sub-classes* (as set out in FEES 6 Annex 2R) and not the remaining capacity in each *sub-class*. [deleted]~~
- 6.5.2C G ~~When FSCS allocates excess *compensation costs levies* otherwise attributable to a *class* which has reached its *levy limit*, in accordance with FEES 6.5.2R(2), a *sub-class* to which any excess has been allocated (the 'receiving *sub-class*') may, as a result of that allocation, itself reach its *levy limit*. In that case, the effect of FEES 6.5.2R is that any resulting excess levy beyond the *levy limit* of the receiving *sub-class* is to be allocated amongst the remaining *sub-classes* whose *levy limits* have not been reached, to the exclusion of the receiving *sub-class*. This process is repeated until the *compensation costs levy* has been met in full or the general retail pool has been exhausted. [deleted]~~
- 6.5.3 R If a *participant firm* which is in default has carried on a *regulated activity* other than in accordance with a *permission*, the FSCS must ~~allocate~~ treat any *compensation costs* or *specific costs* arising out of that activity to the relevant *sub-class* which covers that activity or if a *levy limit* of the relevant *sub-class* or *class* has been exceeded, FSCS must allocate any *compensation costs levy* on the same basis as set out in FEES 6.5.2R as if the relevant *permission* were held by the *participant firm*.
- 6.5.4 R If the relevant *person* in default is an *appointed representative*, the FSCS must ~~allocate~~ treat any *compensation costs* or *specific costs* arising out of a *regulated activity* for which his *principal* has not accepted responsibility to the relevant *sub-class* for that activity or if a *levy limit* of the relevant *sub-*

~~class or class has been exceeded, FSCS must allocate any compensation costs levy on the same basis as set out in FEES 6.5.2R as if the principal had accepted responsibility.~~

- 6.5.5 R (1) A *participant firm* must pay to the FSCS a share of each *compensation costs levy* allocated to the classes of which it is a member unless either the *firm* is exempt under FEES 2 (Exemption) or the FSCS has chosen to exercise its discretion under FEES 6.3.23R in respect of that *firm*.
- (2) ~~If a levy relates solely to costs allocated in excess of a particular levy limit (1) does not apply to a participant firm member of the sub-class or class whose levy limit has been exceeded. [deleted]~~
- 6.5.6 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:
- (1) identifying each of the ~~sub-classes~~ to which each *participant firm* belongs, using the statement of business most recently supplied under FEES 6.5.13R(1);
  - (2) identifying the *compensation costs* falling within FEES 6.5.1R allocated, in accordance with FEES 6.5.2R, to the ~~sub-classes~~ identified in (1);
  - (3) calculating, in relation to each relevant ~~sub-class~~, the *participant firm's* tariff base as a proportion of the total tariff base of all *participant firms* in the ~~sub-class~~, using the statement of business most recently supplied under FEES 6.5.13R;
  - (4) applying the proportion calculated in (3) to the figure in (2); and
  - (5) if more than one ~~class or sub-class~~ is relevant, adding together the figure in (4) for each ~~sub-class~~.

~~Sub-classes~~ Classes and tariff bases for compensation cost levies and specific costs levies

- 6.5.7 R When calculating a *participant firm's* share of a *compensation costs levy* or *specific costs levy* allocated to each ~~sub-class~~ the FSCS must use the ~~sub-classes~~ and tariff bases as set out in the table in FEES 6 Annex 3R.

...

...

Membership of several classes ~~or sub-classes~~

...

- 6.5.12 G A *participant firm* may belong to more than one ~~class, and more than one~~

~~sub-class within the same class.~~

#### Reporting requirements

- 6.5.13 R (1) Unless exempt under *FEES* 6.2.1R, 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, by the date requested by the *FSA*) with a statement of:
- (a) ~~sub-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 (Financial Services Compensation Scheme - classes and ~~sub-classes~~)) ending before the relevant year in relation to each of those ~~sub-classes~~.

...

- (3) ~~This rule does not apply in relation to the home finance provision sub-class E1. Therefore any reference in the Handbook to information that is or must be supplied under this rule must be read, in the case of sub-class E1, as if it referred to the corresponding provisions relating to FSA periodic fees. [deleted]~~

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

...

#### **6.5A** **The retail pool** [to follow]

...

#### **6.7** **Payment of levies**

...

- 6.7.6 R If a *firm* ceases to be a *participant firm* or carry out activities within one or more ~~sub-classes~~ part way through a financial year of the *compensation scheme*:

...

- (2) the *FSCS* may make one or more levies upon it (which may be before or after the ~~firm~~ *firm* has ceased to be a *participant firm* or carry out activities within one or more ~~sub-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~~ *firms* carrying out activities within that *sub-class* in the financial year it ceased to be a *participant firm* or carry out activities within that *sub-class*.

...

...

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

This table belongs to FEES 6.4.2R	
Period	Limit on total of all management expenses levies attributable to that period (£)
...	
1 April 2012 to 31 March 2013	£1,000,000,000
<u>1 April 2013 to 31 March 2014</u>	<u>£[insert figure]</u>

...

### 6 Annex 2 R Financial Services Compensation Scheme – annual levy limits

This table belongs to FEES 6.3.5R and FEES TP 2.5.2R		
Class	Sub-class	Levy Limit (£ million)
Deposit		
	Deposit	1,840
Life and Pensions		
	Life and Pensions Provision	690
	Life and Pensions Intermediation	100
General insurance		
	General Insurance Provision	775
	General Insurance Intermediation	195

Investment		
	Fund management	270
	Investment Intermediation	100
Home Finance		
	Home Finance Provision	70
	Home Finance Intermediation	60

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

### 6 Annex 3R Financial Services Compensation Scheme - classes and sub-classes

This table belongs to FEES 6.5.7 R and ~~FEES TP 2.5.2R~~

<b>Class A</b>	<b><u>Deposit Deposits</u></b>
<b>Legal basis for activity in class A <u>Firms with permission for:</u></b>	...
...	

<b>Class B</b>	<b>General Insurance</b>
<b><u>Sub-class Class B1</u></b>	General Insurance Provision

<b>Legal basis for activity in sub-class B1 <u>Firms with permission for:</u></b>	...
<b>Sub-class <u>Class B2</u></b>	General Insurance Intermediation
<b>Legal basis for activity in sub-class B2 <u>Firms with permission for:</u></b>	...
<b>Tariff base</b>	<del>Sub-class <u>Class B1</u>...</del>
	<p><del>Sub-class <u>Class B2</u>: annual eligible income</del> 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 <del>sub-class B2</del> 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 <del>sub-class B2</del> 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 <del>sub-class B2</del> 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 that payment is of a type that falls under (a).</p> <p>Notes relating to the calculation of the tariff base for <del>sub-class <u>class B2</u></del>:</p> <p>...</p> <p>(3) Net amount retained means all the commission, fees, etc. in respect of <del>sub-class B2</del> activities that the <i>firm</i> has not rebated to customers or passed on to other <i>firms</i> ...</p> <p>(4) <del>Sub-class <u>Class B2</u></del> activities mean activities that fall within <del>sub-class B2</del>. They also include activities that now fall within <del>sub-class B2</del> 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 <del>sub-class B2</del> but which were not at the time <i>regulated activities</i>.</p>

Class C	Life and Pensions
<b>Sub-class <u>Class C1</u></b>	Life and Pensions Provision
<b>Legal basis for activity in sub-class <u>C1 Firms with permission for:</u></b>	...
<b>Sub-class <u>Class C2</u></b>	Life and Pensions Intermediation
<b>Legal basis for activity in sub-class <u>C2 Firms with permission for:</u></b>	...
<b>Tariff base</b>	<p><del>Sub-class <u>Class C1</u></del>:...</p> <p>(1) Eligible mathematical reserves are calculated in accordance with the method for calculating mathematical reserves in fee block A4 in part 2 of <i>FEES 4 Annex 1 R</i> with the following adjustments.</p> <p>...</p> <p>(7) The provisions relating to pension fund management business in Part 2 of <i>FEES 4 Annex 1 R</i> do not apply. A <i>firm</i> undertaking such business that does not carry out any other activities within <del>sub-class C1</del> (ignoring any activities that would have a wholly insignificant effect on the calculation of its tariff base for <del>sub-class C1</del>) must use its Long-term insurance capital requirement instead of gross technical liabilities. ...</p> <p>...</p> <p>Sub-class <u>C2</u>: <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 <del>sub-class C2</del> 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 <del>sub-class C2</del> 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 <del>sub-class C2</del> activities carried out by another <i>firm</i>...</p>

	<p>Notes relating to the calculation of the tariff base for <i>sub-class C2</i>:</p> <p>...</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>sub-class D1</i>.</p> <p>...</p> <p>(4) Net amount retained means all the commission, fees, etc. in respect of <i>sub-class C2</i> activities...</p> <p>(5) <del>Sub-class</del> <u>Class</u> <i>C2</i> activities mean activities that fall within <i>sub-class C2</i>. They also include activities that now fall within <i>sub-class C2</i> but that were not <i>regulated activities</i> when they were carried out.</p> <p>(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>sub-class C2</i> but which were not at the time <i>regulated activities</i>.</p>
--	--

<b>Class D</b>	<b>Investment</b>
<b>Sub-class <u>Class D1</u></b>	Fund management <u>Investment provision</u>
<b>Legal basis for activity in sub-class D1 <u>Firms with permission for:</u></b>	...
<b>Sub-class <u>Class D2</u></b>	Investment Intermediation
<b>Legal basis for activity in sub-class D2 <u>Firms with permission for:</u></b>	...
<b>Tariff base</b>	<del>Sub-class</del> <u>Class</u> <i>D1</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>sub-class D1</i> .
	<del>Sub-class</del> <u>Class</u> <i>D2</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>sub-class D2</i> .

	Notes on <i>annual eligible income</i> for <i>sub-classes</i> D1 and D2:
	(1) For the purposes of calculating annual income, net amount retained means all the commission, fees, etc. in respect of activities falling within <i>sub-class</i> D1 or D2...
...	

<b>Class E</b>	<b>Home Finance</b>
<b>Sub-class E1</b>	Home Finance Provision
<b>Legal basis for activity in sub-class E1</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>Sub-class <u>Class</u> E2</b>	Home Finance Intermediation
<b>Legal basis for activity in sub-class E2 <u>Firms with permission for:</u></b>	...
<b>Tariff base</b>	Sub-class E1: FSA periodic fees
	Sub-class: <u>Class</u> E2: ...

<b>Notes</b>	
...	
(2)	In calculating <i>annual eligible income</i> a <i>firm</i> must apportion income between different <i>sub-classes</i> ...
...	

## 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 <i>sub-class</i> D1 who carry out discretionary fund management and are in FSA fee block A7
--	--

-1.1	G	The tariff base for <i>sub-class</i> D1 is calculated by taking gross income falling into <i>sub-class</i> D1 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). ...
...		
1.2	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>sub-class</i> D2 (the investment intermediation <i>sub-class</i> ).
...		
		Calculation of annual eligible income for firms in sub-class D1 and who carry out activities within <del>FSA</del> <u>FSA</u> fee block A9
2.1	G	The calculation of income in respect of activities falling into <i>sub-class</i> D1 and <i>FSA</i> fee block A9 should be based on the tariff base provisions for that fee block (in Part 2 of <i>FEES</i> 4 Annex 1R). ...
2.2	G	Although the calculation should be based on the one for fee block A9, the calculation is not the same. <i>FSA</i> fee block A9 is based on gross income. <i>Sub-class</i> <u>Class</u> D1 is based on net income retained.
		Calculation of annual eligible income for a firm in <del>sub-class</del> B2 or <del>sub-class</del> C2
...		
		Difficulties in calculating annual eligible income
4.1	G	The purpose of Note 2 in the section of notes at the end of <i>FEES</i> 6 Annex 3R (Financial Services Compensation Scheme - classes <del>and sub-classes</del> ) is to deal with the practical difficulties of allocating income correctly between different <i>sub-classes</i> and in deciding whether income falls outside <i>FEES</i> 6 Annex 3R altogether. ...
...		
		Gross technical liabilities and mathematical reserves for non-directive friendly societies
...		
5.2	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 <i>sub-class</i> B1 (General Insurance Provision) and C1 (Life and Pensions Provision) are based on a valuation. ...

Insert the following after FEES TP 6. The text is not underlined.

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

- 7.1 R As at 31 March 2013, the *FSCS* must:
- (1) allocate any surplus or deficit in the balance of an activity group in respect of *base costs*, as listed in *FEES* 4 Annex 1R, to the account of that activity group as at 1 April 2013; and
  - (2) take that surplus or deficit (so allocated) into account when calculating the amount to be levied under *FEES* 6.4.5R in respect of the financial year commencing on 1 April 2013.

### Part 2: Comes into force on 1 April 2014

## 6 Financial Services Compensation Scheme Funding

### 6.1 Application

...

General structure

...

- 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. ~~The total amount of all *management expenses levies* attributable to a financial year will be restricted to the amount set out on an annual basis in *FEES* 6 Annex 1R.~~ 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, 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 will be restricted to the amount set out on an annual basis in *FEES* 6 Annex 1R.

...

The compensation costs levy

- 6.1.14 G In imposing a *compensation costs levy* in each 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 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) ~~over~~ in the 12 months following the date of the levy; and
- (2) for other protected claims:
  - (a) the compensation costs it expects to incur in the 12 months following the date of the levy; or, if greater
  - (b) one third of the compensation costs it expects to incur in the 36 months following the date of the levy (see *FEES 6.3.1R (Imposing management expenses and compensation costs levies)*).

...

### 6.3 The FSCS's powers 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 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 following the levy; and
  - (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; or, if greater
    - (b) one third of the FSCS's expenditure in respect of compensation costs expected in the 36 months following the levy.
- 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 period of 12 months or, if greater, one third of the expenditure expected in the period of 36

months following 1 July in that year)...

## Annex C

## Amendments to the Supervision manual (SUP)

In this Annex, striking through indicates deleted text

## 16 Annex 18AR Retail Mediation Activities Return ('RMAR')

...

## SECTION J: data required for calculation of fees

Part 1

	<b>FSA</b> Annual Regulated Income (£s)	<b>FOS</b> Relevant Annual Income (£s)	<b>FSCS</b> Annual Eligible Income (£s)
Home Finance Mediation	see <i>FEES</i> 4 Annex 1R Part 2 fee block A18	<i>FEES</i> 5 Annex 1R industry block 16	<i>FEES</i> 6 Annex 3R <del>sub</del> -class E2
Non-investment insurance mediation	see <i>FEES</i> 4 Annex 1R Part 2 fee block A19	<i>FEES</i> 5 Annex 1R industry block 17	<i>FEES</i> 6 Annex 3R <del>sub</del> -class B2
Life and pension intermediation	n/a	n/a	<i>FEES</i> 6 Annex 3R <del>sub</del> -class C2
Investment intermediation	n/a	n/a	<i>FEES</i> 6 Annex 3R <del>sub</del> -class D2
...			

...

## 16 Annex 18BG

## NOTES FOR COMPLETION OF

## THE RETAIL MEDIATION ACTIVITIES RETURN ('RMAR')

...

## Section J: data required for calculation of fees

...

<b>Data for fees calculations</b>	<i>Firms</i> will need to report data for the purpose of calculating <i>FSA</i> , <i>FOS</i> and <i>FSCS</i> levies.
...	
FSCS	The relevant information required is the tariff data set out

	in <del>sub</del> -classes B2, C2, D2, and E2, <i>FEES</i> 6 Annex 3R. Note that <i>firms</i> are required to report tariff data information relating to all business falling within <del>sub</del> -classes B2, C2, D2 and E2, <i>FEES</i> 6 Annex 3R.
--	--

...

## Annex D

## Amendments to the Dispute Resolution: Complaints sourcebook (DISP)

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

## 1 Annex 1AG Recommended metrics

This table belongs to DISP 1.10A.8G

Type of business	Contextualised new complaint numbers	Recommended metrics
...		
Investment ( <del>fund management</del> <u>provision</u> )	<i>Complaints</i> per £1m of annual eligible income	The <i>firm's</i> annual eligible income as defined in <del>sub</del> -class D1 of <i>FEES</i> 6 Annex 3R
Investment (intermediation)	<i>Complaints</i> per £1m of annual eligible income	The <i>firm's</i> annual eligible income as defined in <del>sub</del> -class D2 of <i>FEES</i> 6 Annex 3R
...		
Decumulation, life and pensions (intermediation)	<i>Complaints</i> per £1m of annual eligible income	The <i>firm's</i> annual eligible income as defined in <del>sub</del> -class C2 of <i>FEES</i> 6 Annex 3R
...		

**Annex E****Amendments to the Compensation sourcebook (COMP)**

In this Annex, striking through indicates deleted text.

- 14.5.1 R Where an *EEA UCITS management company* 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*, the *FSCS* must allocate the *firm* to the ~~*sub-class*~~ or ~~*sub-classes*~~ which seems to the *FSCS* to be most appropriate, taking into account the nature of the *firm's* business activities

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The Financial Services Authority  
25 The North Colonnade Canary Wharf London E14 5HS  
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099  
Website: [www.fsa.gov.uk](http://www.fsa.gov.uk)

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