

Chapter 4

Periodic fees

Guidance on the calculation of tariffs set out in FEES 4 Annex 1AR Part 3

Table 1

The following table sets out *guidance* on how a *firm* should calculate tariffs for fee blocks A.13, A.14, A.18, A.19, A.23 and B. Service Companies, Recognised Investment Exchanges, Multilateral Trading Facilities, Organised Trading Facilities, Regulated Benchmark Administrators and Claims Management Companies.

Calculating and apportioning annual income - FEES 4 Annex 11AR

Calculating annual income

Defining relevant income streams

- (1) The *firm* should refer to the fee-block definitions in FEES 4 Annex 1AR, Part 1 to decide which particular income streams should be taken into account when calculating its annual income for the purposes of fee-blocks A.13, A.14, A.18, A.19 and B. Service Companies, Recognised Investment Exchanges, Multilateral Trading Facilities, Organised Trading Facilities and Benchmark Administrators.
- (2) For the avoidance of doubt, the only income streams reportable for a relevant fee-block are those income streams which relate to a *regulated activity* listed in that fee-block. Income streams that do not relate to a *regulated activity* listed in the relevant fee-block should not be reported. *Service companies, operators of recognised investment exchanges, multilateral trading facilities, organised trading facilities and regulated benchmark administrators* should report the income relating to each of these activities, excluding income from any other activities in the B fee-block on which they pay FCA fees. Operators of *recognised investment exchanges* should include all income derived from operating *multilateral trading facilities* and *organised trading facilities*.

Under FEES 4 Annex 11AR, where the sales and marketing of a benchmark are undertaken by a separate legal entity within the same *group*, the income generated as a result is also deemed to relate to the *regulated activity* carried on by the *benchmark administrator* and so should be reported to the FCA by the *benchmark administrator* as its own income (for fees setting purposes).

Firms should exclude from the calculation of their annual income for any particular fee-block all income directly derived from the performance of *regulated activities* belonging to other fee-blocks. For example:

- (a) interest from loans made in the course of providing or administering home finance (A.2) should be excluded from commission earned from arranging home finance agreements (A.18);
 - (b) premium interest from carrying out or effecting life insurance contracts (A.3), income from managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyds (A.5) should be excluded from commissions for arranging general insurance (A.19);
 - (c) income from managing investments, collective investment schemes or pensions schemes (A.7 or A.9) or income from operating *multilateral trading facilities* should be excluded from income derived from investment intermediation (A.13) or operating a *recognised investment exchange* or administering a *specified benchmark*.
- (3) *Firms* should only include revenue streams that relate to *regulated activities* which are carried on 'in the *United Kingdom*'. In many cases, it will be quite straightforward to identify where an activity is carried on. But when there is a cross-border element, for example because a client is outside the *United Kingdom* or because some other element of the activity

happens outside the *United Kingdom*, the question may arise as to where the activity is carried on. PERG 2.4 generally and PERG 4.11 regarding activities relating to *regulated mortgage contracts*, PERG 5.12 regarding activities relating to *insurance distribution activities* and PERG 14.6 regarding *home reversion plans* and *home purchase plans* describe the legislation that is relevant to this question and gives the *FCA's* views on various scenarios.

Reporting period

- (4) Except for *claims management companies*, the "reporting year" is the *firm's* financial year end during the calendar year prior to the *FCA fee year*. This *fee year* starts on 1 April. This is specified in part 5 of FEES 4 Annex 1A.
- (5) The income that should be included is the income that was recognised in the accounts of the relevant reporting year. This means that some income due may not be reported until the following year because it has not yet been recognised in the accounts, while other income may be carried forward from previous years.

Fair value

- (6) Except in relation to fee-block A.18 and A.19 where one or more of paragraphs (d) to (f) or (g) to (i) of FEES 4 Annex 11A apply, the *firm* should report a "fair value" price for any services for which it has made a business decision not to charge to *clients*.

We consider fair value to refer to the amount at which goods or services could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale.

For example, where a *firm* has forgone or discounted the *commission* or *fee* would actually have charged but for the business decision to grant a discount in a particular case or on a temporary basis, it should report the amount it would have otherwise have charged for providing equivalent activities.

In the case of *home finance mediation* in fee-block A.18 and general insurance intermediation in fee-block A.19 where one or more of paragraphs (e) to (f) or (g) to (i) of FEES 4 Annex 11A apply, instead of asking for firms to estimate fair value, certain ratios are prescribed in FEES 4 Annex 11BR where the *client* is not charged directly for the service provided.

Inclusions

- (7) Annual income should include:
- (a) all amounts due to the *firm* arising out of the *regulated activities* referred to in the relevant fee block for which the *firm* holds *permission*, including regular *charges* and instalments due to the *firm* during the reporting year;
 - (b) any payment from a parent to facilitate the discounting or forgoing of any amounts that would otherwise be charged in full to a *client*, to the extent that the payment exceeds the "fair value" price reported in accordance with paragraph (6) above;
 - (c) (i) amounts earned by a *firm's* appointed representative when carrying on a *regulated activity* for the *firm* to which FEES 4 Annex 11A applies; and
(ii) amounts earned by a *person* who will become the *firm's* appointed representative immediately after *authorisation*;
 - (d) administrative charges and any interest from income related to the *regulated activities* specified in the relevant fee block.
- (8) Additional inclusions in respect of fee-block A.18:
- (a) a *firm* must include in paragraph (a) any survey and booking fees due to it in respect of *home finance mediation activity*.

Prohibited deductions

- (9) Deductions should not be made for:
- (a) bad debts;
 - (b) customer benefits such as cash rewards, complimentary travel insurance, air miles vouchers etc.;

- (c) items such as general business expenses (e.g. employees' salaries and overheads);
- (d) fines or penalties levied against the *firm*;
- (e) commission a *firm* pays another party to arrange a transaction with a *client* unless it receives a *fee* in respect of the same transaction;
- (f) the difference (if positive) between the fee payable by a *firm* to another party for arranging a transaction and the amount payable to the *firm* by the end *client* in respect of that transaction (here, the *firm* must net any excess payable by the end *client* to zero);
- (g) payments made to *clients* by way of redress.

Exclusions

(10) The following should be excluded from the calculation of annual income:

- (a) To avoid double-counting, amounts which have been passed on to other *firms* may be excluded from the calculation of annual income, for example, where there is a commission chain. Transfers of income to other *firms* may be especially common within *groups* where, to present a single interface to *clients*, all amounts due to the *group* may be collected by one *firm* for subsequent redistribution to other *firms* within the group. It is for *groups* themselves to decide the most convenient way to report such annual income - i.e. whether the *firm* which receives the full amount should declare that full amount, or whether each *firm* in the *group* should report its separate distribution.
- (b) Any payment from a parent to facilitate the discounting or forgoing of any amount that would otherwise be charged in full to a *client* should be excluded to the extent that the payment does not exceed or equal the "fair value" price reported in accordance with paragraph (6) above.
- (c)
 - (i) rebates to *customers* and members of a *recognised investment exchange, multi-lateral trading facility and organised trading facility*; and
 - (ii) *fees or commissions* passed onto other *firms*.
- (d) *Authorised professional firms* should exclude the income from *non-mainstream regulated activities*. They may estimate the proportion of their business that is derived from those activities and split the income from individual invoices accordingly.
- (e) For the avoidance of doubt, income relating to or in respect of an activity is not part of annual income for the purposes of the definition in FEES 4 Annex 11A to the extent that the activity benefits from the exclusion in article 69 of the Financial Services and Markets Act 2000 (Regulated Activities Order) 2001 (Groups and joint enterprises). *Firms* should refer to the *guidance* on the application of this exclusion is contained in PERG 2.9.

Apportioning annual income

Where a *firm* cannot separate its income on the basis of activities, it may apportion the income on the basis of the proportionate split of business that the *firm* otherwise undertakes. For instance:

- (1) If a *firm* receives annual income from a platform-based business it may report this in line with a wider breakdown of its activities.
- (2) A *firm* providing corporate finance advice which does not maintain records of the split between *regulated activities* and non-regulated activities for individual cases may calculate that regulated business accounts for a certain proportion of its business overall and apply that as a multiplier across its income.
- (3) A *firm* may allocate ongoing *commission* from previous business on the basis of the type of *firm* it receives the *commission* from. This avoids tracking back legacy business which may no longer match the provider's current business model.
- (4) An *authorised professional firm* may estimate the proportion of its business that is derived from *regulated activity* and split its income for individual invoices accordingly.

- (5) If a *firm* has invested income from *regulated activities*, then any interest received should be reported as income, in proportion to the volume of regulated business it undertakes to avoid tracking back old payments.
- (6) *Firms'* systems ought to be able to distinguish *UK* from non-*UK* business to establish which conduct of business regime it was conducted under. If, however, they do not relate the figures back to income streams for the specific *regulated activities* in a particular fee-block then the *firm* may make a proportionate split as described above, calculating its regulated *UK* income on the basis of the overall split between *UK* and overseas income.
- (7) It is for individual *firms* to determine how they should calculate the appropriate split of income. The *FCA* is not prescriptive about the methodology. It requires only that:
 - (a) the approach should be proportionate - the *FCA* is looking for *firms* to make their best efforts to estimate the split;
 - (b) the *firm* must be able on request to provide a sound and clearly expressed rationale for its approach - for example, if all invoices were analysed over a particular period, the *firm* should be able to justify the period as representative of its business across the year;
 - (c) the methodology should be objective - for example, based on random sampling of invoices or random stratified sampling;
 - (d) the *firm* must on request be able to provide an audit trail which demonstrates that the choice of methodology was properly considered at an appropriate level or in the appropriate forums within the *firm*, and the decision periodically reviewed at the same level or in an equivalent forum.

Table 2

The following table sets out *guidance* on how a *firm* should calculate tariffs for fee blocks CC.1 and CC.2.

Calculating and apportioning annual income - FEES 4 Annex 11BR

Calculating annual income

Defining relevant income streams

- (1) *Firms* should report the total income from the *credit-related regulated activities* for which they have *permission*.
- (2) *Firms* should only include revenue streams that relate to *regulated activities* which are carried on 'in the *United Kingdom*'. In many cases, it will be quite straightforward to identify where an activity is carried on. But when there is a cross-border element, for example because a client is outside the *United Kingdom* or because some other element of the activity happens outside the *United Kingdom*, the question may arise as to where the activity is carried on. PERG 2.4 describes the legislation that is relevant to this question.

Reporting period

- (3) The "reporting year" is the *firm's* financial year end during the calendar year prior to the *FCA fee year*. This *fee year* starts on 1 April. This is specified in part 5 of FEES 4 Annex 1A.
- (4) The income that should be included is the income that was recognised in the accounts of the relevant reporting year. This means that some income due may not be reported until the following year because it has not yet been recognised in the accounts, while other income may be carried forward from previous years.

Fair value

- (5) The *firm* should report a "fair value" price for any services for which it has made a business decision not to charge to *clients*. We consider fair value to refer to the amount at which goods or services could be exchanged in an arm's length transaction between informed and willing parties, other than in a forced or liquidation sale.

Some examples where fair value may be relevant in the context of consumer credit are:

- (a) "Imputed interest": where a loan has been provided interest-free or at a discounted rate, the charge should be rounded up to the prevailing rate normally chargeable to a *client* with a similar credit rating;

(b) "Commission-equivalent" or "fee-equivalent": where a *firm* has foregone or discounted the *commission* or *fee* it would actually have charged but for the business decision to grant a discount in a particular case or on a temporary basis, it should report the amount it would otherwise have charged for providing equivalent *credit-related regulated activity*.

(6) *Firms* should not estimate a fair value where:

(a) there is a statutory prohibition on charging interest (such as bankruptcy debts); or

(b) they have reduced or suspended their normal charging structure because the debtor is unable to meet contractual repayments and an alternative repayment arrangement has been agreed with the creditor; or

(c) they have made a "borrower-lender-supplier" agreement to allow a customer to pay the cash price of goods or services in instalments - any penalties or interest charged where the customer is in default should be declared as income.

(6A) [deleted]

(6B) Proxy measure of annual income FEES 4 Annex 11BR(2)

FEES 4 Annex 11BR(2) sets out the proxy measure of annual income for a *firm* defined in FEES 4 Annex 11BR(1)(e). An example of what a *firm* would report as a proxy measure of annual income is provided below:

If a *firm* enters into a *regulated credit agreement* as *lender*, providing a gross loan amount of £1,000 to enable a *customer* to purchase goods from it priced at £1,000, the *firm* should report: $5\% \times £1000 = £50$.

Inclusions

(7) Annual income should include:

(a) all amounts due to the *firm* arising out of *credit-related regulated activities* for which the *firm* holds *permission*, including regular *charges* and instalments due to the *firm* during the reporting year;

(b) income received in relation to the provision of current account overdrafts interest charges, arrangement fees and credit cards charges;

(c) any payment from a parent to facilitate the discounting or forgoing of any amounts that would otherwise be charged in full to a *client*, to the extent that the payment exceeds the "fair value" price reported in accordance with paragraph (5) above;

(d) (i) amounts earned by the *firm's appointed representatives* when carrying on a regulated activity for the *firm* to which FEES 4 Annex 11B R applies; and

(ii) amounts earned by a *person* who will become the *firm's appointed representative* immediately after *authorisation*; and

(e) administrative charges and any interest from income related to its *credit-related regulated activity*.

Prohibited deductions

(8) Deductions should not be made for:

(a) bad debts;

(b) customer benefits such as cash rewards, complimentary travel insurance, air miles vouchers etc;

(c) items such as general business expenses (eg, employees' salaries and overheads);

(d) fines or penalties levied against the *firm*;

(e) commission a *firm* pays to another party to arrange a transaction with a *client* unless it receives a *fee* in respect of the same transaction;

- (f) the difference (if positive) between the fee payable by a *firm* to another party for arranging a transaction and the amount payable to the *firm* by the end *client* in respect of that transaction (here, the firm must net any excess payable by the end client to zero);
- (g) payments to *clients* made by way of redress; and
- (h) commission or fees clawed back by a third party *firm* in subsequent years, for example because a *client* introduced by a *credit broker* to a *lender* repays a loan early or defaults.

Exclusions

- (9) The following should be excluded from the calculation of annual income:
 - (a) Any income arising from business which is not a *credit-related regulated activity*.
 - (b) (i) Repayments of principal lent by the *firm* in the course of it carrying on a *credit-related regulated activity* and (ii) sums received by the *firm* in exchange for the rights to principal owed to the *firm* where the principal was lent by the *firm* in the course of carrying on a *credit-related regulated activity* and where the rights are not sold at a premium to the value of the principal outstanding, should not be included. By the same token, the money a *firm* has received for the purpose of lending on to consumers as principal (e.g. money raised through wholesale borrowing, grant-aid, intra-group transfers, etc) should not be treated as income.
 - (c) On the same principle, the income on debt purchase is the difference between the price paid for the purchased book and the amount collected.
 - (d) To avoid double-counting, amounts which have been passed on to other *firms* carrying on *credit-related regulated activity* may be excluded from the calculation of annual income, for example where there is a commission chain. Transfers of income to other *firms* may be particularly common within *groups* where, to present a single interface to *clients*, all amounts due to the *group* may be collected by one firm for subsequent redistribution to other *firms* within the *group*. It is for *groups* themselves to decide the most convenient way to report such annual income, ie whether the *firm* which receives the full amount should declare that full amount or whether each *firm* in the *group* should report its separate distribution.
 - (e) Any payment from a parent to facilitate the discounting or forgoing of any amount that would otherwise be charged in full to a *client* should be excluded to the extent that the payment does not exceed or equal the "fair value" price reported in accordance with paragraph (6) above.
 - (f) Rebates to *customers* and *fees* or *commissions* passed onto other *firms* should be excluded.
 - (g) The costs of wholesale funding should be excluded from the calculation - ie interest payments on money borrowed in order to lend on to customers.
 - (h) If the total income a *firm* reports to us in one year includes an estimate for potential income which had been recognised in the accounts but not in practice received, and which has subsequently been written off as a bad debt, the amount may be deducted from the following year's reported income.
 - (i) Any debit backs deducted from an intermediary by a lender where a customer settles the loan early or defaults.
 - (j) *Authorised professional firms* should exclude the income from *non-mainstream regulated activities*. They may estimate the proportion of their business that is derived from those activities and split the income from individual invoices accordingly.
 - (k) For the avoidance of doubt, income relating to operating current accounts and debit card transactions should be excluded except where the income relates to the provision of overdrafts (see paragraph (6)(c) above).
 - (l) For the avoidance of doubt, income relating to or in respect of an activity is not part of annual income to the extent that the activity benefits from the exclusion in article 69 of the Financial Services and Markets Act 2000 (Regulated Activities

Order) 2001 (Groups and joint enterprises). *Firms* should refer to the *guidance* on the application of this exclusion is contained in PERG 2.9.

- (m) Where a *consumer hire agreement* is open ended, its term should be taken as the period over which depreciation is calculated to zero. If the agreement is in practice terminated before depreciation reaches zero, the residual value may not be subtracted from the revenue. Where an agreement ends before depreciation reaches zero, but is subsequently renewed, the residual value of the asset should determine its cost at the beginning of the new agreement and depreciation re-calculated accordingly. For example, if the cost of the asset at the start of the original agreement was £500 and depreciation was 80%, then its residual value carried forward to the new agreement would be £100. If the asset was assumed to depreciate to zero during the original agreement, then there is no residual value to carry forward and the income for the second agreement would be the total revenue from the lease.

Apportioning annual income

Where a *firm* cannot separate its income on the basis of *credit-related regulated activities*, it may apportion the income on the basis of the proportionate split of business that the *firm* otherwise undertakes. Examples are outlined below.

- (1) If a *firm* receives annual income from a platform-based business it may report this in line with a wider breakdown of its activities.
- (2) A *firm* may allocate ongoing *commission* from previous business on the basis of the type of *firm* it receives the *commission* from. This avoids tracking back legacy business which may no longer match the provider's current business model.
- (3) If a *firm* has invested income from *credit-related regulated activities*, then any interest received should be reported as income, in proportion to the volume of business relating to *credit-related regulated activities* it undertakes to avoid tracking back old payments.
- (4) *Firms'* systems ought to be able to distinguish *UK* from non-*UK* business to establish which conduct of business regime it was conducted under. However, if, a *firm* has a mix of business and its systems do not relate the figures back to the income streams from *credit-related regulated activities*, then it may make a proportionate split as described above, calculating its regulated *UK* income on the basis of the overall split between *UK* and non-*UK* income.
- (5) An *authorised professional firm* may estimate the proportion of its business that is derived from *regulated activity* and split its income for individual invoices accordingly.
- (6) It is for individual *firms* to determine how they should calculate the appropriate split of income. The *FCA* is not prescriptive about the methodology. It requires only that:
 - (a) the approach should be proportionate - the *FCA* is looking for *firms* to make their best efforts to estimate the split;
 - (b) the *firm* must be able on request to provide a sound and clearly expressed rationale for its approach - for example, if all invoices were analysed over a particular period, the *firm* should be able to justify the period as representative of its business across the year;
 - (c) the methodology should be objective - for example, based on random sampling of invoices or random stratified sampling; and
 - (d) the *firm* must on request be able to provide an audit trail which demonstrates that the choice of methodology was properly considered at an appropriate level or in the appropriate forums within the *firm*, and the decision periodically reviewed at the same level or in an equivalent forum.