

## Chapter 6

# Financial Services Compensation Scheme Funding

**6.1 Application**

**6.1.1** **R** This chapter applies to:

- (1) every *participant firm*;
- (2) the *FSCS*; and
- (3) the *Society*.

**6.1.2** **G** (1) *Firms* which are not *participant firms* (such as certain types of *incoming EEA firms*, *service companies* and *ICVCs*) are not required to contribute towards the funding of the *compensation scheme*.

(2) The fees levied in relation to the carrying on of *insurance market activities* by *members* will be imposed on the *Society* rather than individually on each *member* (see ■ FEES 6.3.24 R).

**Purpose**

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

**General structure**

**6.1.4** **G** Section 213(3)(b) of the *Act* requires the *appropriate regulator* to make *rules* to enable the *FSCS* to impose levies on *authorised persons*, and on *recognised investment exchanges* that are *operating a multilateral trading facility* or *operating an organised trading facility*, 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 *appropriate regulator* 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 up to the greater of one third of the compensation costs expected in the 36-month period following the 1 April of the *financial year* of the *compensation scheme* in relation to which the levy is imposed, or the *compensation costs* expected in the 12 *months* following that date.

**6.1.6A** **G** The total amount of all *management expenses levies* attributable to a *financial year* and levied by the *FSCS* under this chapter or under the *PRA Rulebook* will be restricted to the amount set out on an annual basis in ■ FEES 6 Annex 1 R.

**6.1.7A** **G** In order to allocate a share of the amount of *specific costs* and *compensation costs* to be funded by an individual *participant firm*, the funding arrangements are split into ten *classes*: the investment provision *class*; the life distribution and pensions intermediation *class*; the home finance intermediation *class*; the investment intermediation *class*; the general insurance distribution *class*; the deposit acceptor's contribution *class*; the insurers - life contribution *class*; the insurers - general contribution *class*; the home finance providers and administrators' contribution *class* and the debt management claims *class*. The *permissions* held by a *participant firm* determine into which *class*, or *classes*, it falls.

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

**The management expenses levy**

**6.1.9** **G** Section 223 of the *Act* (Management expenses) prevents the *FSCS* from recovering, through a levy, any *management expenses* attributable to a particular period in excess of the limit set in *COMP* as applicable to that period. 'Management expenses' are defined in section 223(3) to mean expenses incurred or expected to be incurred by the *FSCS* in connection with its functions under the *Act*, except:

- (1) expenses incurred in paying compensation;
- (2) expenses incurred as a result of the *FSCS* making the arrangements to secure continuity of insurance to make payments to or in respect of policyholders or to safeguard policyholders, under *PRA rules* made under sections 216(3) or (4), 217(1) or 217(6) of the *Act*;
- (3) expenses incurred under section 214B or section 214D of the *Act* as a result of the *FSCS* being required by HM Treasury to make payments

in connection with the exercise of the stabilisation power under Part 1 of the Banking Act 2009; and

- (4) expenses incurred under Part XVA of the Act as a result of the FSCS being required by HM Treasury to act in relation to a *relevant scheme*.

**6.1.10** **G** A *management expenses levy* may consist of two elements. The first is a *base costs levy*, for 50% of the base costs of running the *compensation scheme* in a *financial year*, that is, costs which are not dependent upon the level of activity of the *compensation scheme* and which therefore are not attributable to any specific *class*. The PRA allocates the other 50% of the base costs under its rules. Included in base costs are items such as the salary of the members of the board of the FSCS, the costs of the premises which the FSCS occupies, and its audit fees. It would also likely include the cost of any insurance cover secured by FSCS against the risk of it paying claims out in circumstances where the *levy limit* of the particular *class* to which the claim would otherwise be attributable has exceeded its *levy limit* for the year, as the insurance cover is likely to benefit all *classes* which may have costs allocated to them if the *levy limit* of another *class* is breached. The amount that each *participant firm* pays towards a *base costs levy* is calculated by reference to the *regulatory costs* paid by the *firm*. All *participant firms* are liable to contribute towards a *base costs levy*.

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

**6.1.12** **G** [deleted]

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

**The compensation costs levy**

**6.1.14** **G** In imposing a *compensation costs levy* in each *financial year* of the *compensation scheme* the *FSCS* will take into account the *compensation costs* which the *compensation scheme* has incurred and has not yet raised through levies, any recoveries it has had made using the rights that have been assigned to it or to which it is subrogated and a further amount calculated taking into account:

- (1) [deleted]
- (2) [deleted]
- (3) the *compensation costs* it expects to incur in the *financial year* of the *compensation scheme* in relation to which the levy is imposed; or, if greater
- (4) one third of the *compensation costs* it expects to incur in the 36 *months* following 1 April of the *financial year* of the *compensation scheme* in relation to which the levy is imposed (see ■ FEES 6.3.1R (Imposing management expenses and compensation costs levies)).

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

- (1) [deleted]
- (2) [deleted]
- (3) [deleted]
- (4) as a result of the *FSCS* being required by HM Treasury to make payments in connection with the exercise of the stabilisation power under Part 1 of the Banking Act 2009; or
- (5) in paying interest, principal and other costs from borrowing to allow the *FSCS* to pay claims attributable to a particular *class*;

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

**Participant firms that are members of more than one class**

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

**The retail pool**

**6.1.16A** **G** The *FCA* has made *rules* providing that *compensation costs* and *specific costs* attributable to the intermediation *classes*, the investment provision *class* and

the debt management claims *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*) (see ■ FEES 6 Annex 5R). The *FCA provider contribution classes* may contribute to *compensation costs levies* or *specific costs levies* funded by the *retail pool*, but may not themselves receive any such funding. The *FCA provider contribution classes* have a different tariff structure to the other *classes*, based on regulatory costs or the *PRA Rulebook* (see ■ FEES 6 Annex 3AR).

### Incoming EEA firms

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*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 firm's* 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 class*.