



BANK OF ENGLAND
PRUDENTIAL REGULATION
AUTHORITY

Consultation Paper | CP7/16

Implementing risk-based levies for the Financial Services Compensation Scheme deposits class

March 2016

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Registered in England and Wales No: 07854923



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Responses are requested by 3 June 2016.

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1 Overview

1.1 In this consultation paper (CP), the Prudential Regulation Authority (PRA) sets out proposals for amendments to the Depositor Protection Part of the PRA Rulebook and a new statement of policy in relation to the calculation of firm contributions to the Financial Services Compensation Scheme (FSCS).

1.2 PRA rules in the Depositor Protection Part currently require the FSCS to calculate firm levies solely on the basis of covered deposits. Article 13 of the recast Deposit Guarantee Schemes Directive (DGSD)¹ requires that contributions to Deposit Guarantee Schemes (DGSs) should additionally be adjusted for the degree of risk incurred by each DGS member. The European Banking Authority (EBA) has issued guidelines² to specify methods for calculating such contributions, as required by Article 13(3) of the DGSD.

1.3 In PS6/15,³ the PRA published final rules to implement the majority of the provisions in the DGSD. At that time, the PRA noted HM Treasury's intention to make use of the option in Article 20(1)(3) of the DGSD to delay the implementation of Article 13, which introduces risk-based levies, until 31 May 2016. Accordingly, the PRA stated it would publish a consultation paper on risk-based levies after the EBA guidelines were finalised. Now that these guidelines have been published, the PRA is setting out its proposed methodology towards the calculation of such risk-based levies that would apply to the repayment of both future compensation costs and existing legacy costs incurred by the FSCS.

1.4 Appendix 1 of this CP contains the proposed amendments to the Depositor Protection rules found in the Depositor Protection Part of the PRA Rulebook. Appendix 2 contains a proposed new statement of policy, specifying the calculation methodology for risk-based levies.

1.5 This consultation is relevant to:

- UK banks, building societies and credit unions as well as to overseas firms with PRA deposit-taking permission; and
- the FSCS, as the UK's administrator of its DGS.

Proposals under consultation

1.6 The PRA proposes:

- amendments to the rules governing the funding of the FSCS in Chapters 34, 39 and 42 of the Depositor Protection Part that would require the FSCS to adjust compensation cost levies for the degree of risk incurred by a DGS member. These would take effect from the 2017 levy cycle;
- amendments to rules in Chapter 36 of the Depositor Protection Part requiring the FSCS to similarly risk-adjust legacy costs levies; and

1 Directive 2014/49/EU, Deposit Guarantee Schemes Directive; <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0049&from=EN>.

2 'Guidelines on methods for calculating contributions to deposit guarantee schemes'; https://www.eba.europa.eu/documents/10180/1089322/EBA-GL-2015-10_GL+on+Calculation+of+Contributions+DGS.pdf/92da0adb-3e16-480f-8720-94f744ea7a44.

3 *PRA Policy Statement PS6/15*, 'Depositor and dormant account protection', April 2015; www.bankofengland.co.uk/pr/Pages/publications/ps/2015/ps615.aspx.

- a new statement of policy, specifying how the PRA intends to calculate the degree of risk incurred by a DGS member. Levies for all deposit-takers would be risk-based, but the PRA proposes different calculation methodologies for Capital Requirements Regulation (CRR) firms, credit unions and non-EEA branches due to their different legal and supervisory regimes.

1.7 Chapter 2 of this CP summarises the proposals under consultation.

1.8 Chapter 3 considers the PRA's statutory obligations.

Responses and next steps

1.9 This consultation closes on **3 June 2016**. The PRA invites feedback on the proposals set out in this consultation. Please address any comments or enquiries to:
CP7_16@bankofengland.co.uk.

2 The PRA's proposals

2.1 The DGSD requires contributions made under the directive funding requirements to be based on the degree of risk incurred by each firm. This chapter explains the PRA's proposals in respect of implementing the risk-based levy framework, which will apply to levies raised from July 2017 onwards.

2.2 The PRA also proposes that levies to repay legacy costs incurred by the FSCS in paying compensation in respect of failures prior to 3 July 2015 (ie prior to the implementation of the DGSD) are similarly risk-based. As stated in CP20/14,¹ the PRA considers that treating legacy cost levies consistently with compensation cost levies would be the simplest approach both for firms and the FSCS.

2.3 Appendix 1 contains the PRA's proposed amendments to Chapters 34, 36, 39 and 42 of the Depositor Protection Part to require firm compensation cost and legacy cost levies to be adjusted for the degree of risk incurred by each firm. This adjustment for risk will be calculated by the PRA in line with the EBA guidelines on risk-based contributions, and provided to the FSCS for each levy cycle.

Risk-based levy: calculation methodology

2.4 The PRA's proposed methodology to calculate the risk adjustment is included in a new statement of policy (Appendix 2). Within the overarching risk-based levy framework specified by the EBA guidelines, the PRA proposes to use different calculation methodologies for three different groups of firms:

- (i) CRR firms:² The EBA guidelines require the use of core risk indicators, derived from a mixture of COREP³ (CRR common reporting) and legacy Financial Services Authority (FSA) returns that all CRR firms are required to submit. The PRA proposes that in calculating the risk adjustment metric for CRR firms, no further indicators are added to the core indicators specified by the guidelines. The calibration scales for the indicators are included in Chapter 3 of the statement of policy in Appendix 2.
- (ii) Credit unions: Since credit unions do not submit COREP or legacy FSA returns, the PRA proposes a bespoke calculation methodology for credit unions. This uses the framework specified in the EBA guidelines, but with a set of risk indicators drawn from 'CY returns',⁴ closely aligned to the core EBA guideline indicators. The calibration scales for these indicators are included in Chapter 3 of the statement of policy in Appendix 2.
- (iii) Non-EEA branches: Non-EEA branches are out of the scope of EBA guidelines. Accordingly, the PRA proposes to rate all non-EEA branches as average risk, for the purposes of the risk-based levy methodology. The PRA considers that this is a pragmatic and proportionate approach since the PRA does not systematically collect from non-EEA branches prudential risk data of the kind specified by the EBA guidelines.

1 PRA Consultation Paper CP20/14, 'Depositor protection', October 2014; www.bankofengland.co.uk/pr/Pages/publications/cp/2014/cp2014.aspx.

2 A UK bank, a building society or a UK designated investment firm.

3 The implementing technical standards contained in the Commission Implementing Regulation (EU) No 680/2014.

4 As required under the Regulatory Reporting Part of the PRA Rulebook.

3 Statutory obligations

3.1 In discharging its general functions of making rules, and determining the general policy and principles by reference to which it performs particular functions, the PRA must, so far as reasonably possible, act in a way that advances its general objective to promote the safety and soundness of the firms it regulates.¹ These proposals advance the PRA's general objective by establishing a sound funding framework for the FSCS and thereby minimise the adverse effect that the failure of a PRA-regulated firm could be expected to have on the stability of the UK financial system. A sound funding framework for the FSCS also enhances depositor confidence in the compensation scheme and therefore contributes to financial stability.

Regulatory principles

3.2 In making its rules and establishing its practices and procedures, the PRA has had regard to the regulatory principles as set out in the Financial Services and Markets Act 2000 (FSMA).²

Four of the principles are of particular relevance:

- *The principle that a burden or restriction which is imposed on a person should be proportionate to the benefits, considered in general terms, which are expected to result.* The PRA has followed this principle in the formulation of the proposals in this CP, and is proposing no additional requirements on firms (other than the amount of compensation cost and legacy cost levies). In particular, the bespoke calculation methodologies for credit unions and non-EEA branches will not require any additional reporting by these firms.
- *The need to use the resources of the PRA in the most efficient and economic way.* The PRA will calculate the risk adjustment metrics and provide them to the FSCS. The PRA is not proposing to collect tariff data and perform the levy calculation itself, as these functions are more efficiently conducted by the FSCS.
- *The desirability of the PRA exercising its functions in a way that recognises differences in the nature and objectives of businesses carried on by different firms.* The PRA has recognised the difference in firm business models, legal and supervisory regimes, and has proposed bespoke methodologies for credit unions and non-EEA branches.
- *The principle that the PRA should exercise its functions as transparently as possible.* The draft statement of policy (Appendix 2) specifies the indicators, weights and calibration scales the PRA proposes to use to calculate the risk-adjustment metrics.

Economic impact

3.3 The PRA is required to perform an analysis of the economic impact in respect of proposed rules.³ The level of the total compensation cost and legacy cost levies will be unaffected by the proposals. However, there will be a reallocation of levies within the deposit-taking sector (compared to the status quo). The exact impact on individual firms will depend on their risk profiles based on regulatory data submitted, and will also vary from year to year. There are no additional reporting requirements proposed for firms, as the risk-adjustment metrics would be calculated using data that firms already submit in PRA regulatory returns.

1 See s.2B(1) and s.2B(2) FSMA.

2 See s.2H and s.3B FSMA.

3 See s.138J(2)(a) FSMA.

3.4 The PRA and the FSCS may face some costs in implementing the new framework, which would be passed on to firms through PRA fees and FSCS Management Expenses, respectively. However, any such costs are expected to be minimal.

Impact on mutuals

3.5 FSMA requires that the PRA assesses whether, in its opinion, the impact of the proposed rules on mutuals will be significantly different from the impact on other firms.¹

3.6 The PRA's proposed methodology is designed so that the impact on mutuals is not significantly different to the impact on other deposit-takers. For example, the PRA proposes to calibrate certain risk-adjustment metrics so that building societies are not adversely impacted by the calculation methodology (see Chapter 3 in Appendix 2). The PRA is also proposing a bespoke calculation methodology for credit unions using existing data from regulatory returns that credit unions already submit (since it is not possible to extend the methodology specified by the EBA guidelines to such firms) to achieve an outcome consistent with other firms.

Impact on competition

3.7 When discharging its general rule-making function, the PRA is legally required, so far as is reasonably possible, to facilitate effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities. The PRA considers that the proposals in this CP facilitate effective competition.

3.8 While each firm's degree of risk adjustment metric will vary annually depending upon regulatory data submissions, the PRA's analysis (on the basis of 2014/15 firm regulatory data) indicates that smaller firms (those whose supervisor has indicated are impact category 2 or lower) will, on average, pay a lower levy under the proposed risk-based framework than currently. Smaller firms are, therefore, unlikely to be hindered from a competitive perspective by the proposed policies, compared with the larger firms who have a much greater market share.

3.9 The PRA's competition objective was embedded in its approach to negotiating the EBA guidelines. In particular, the PRA strongly argued in favour of allowing the risk-weighted assets risk metric to be calibrated differentially for those firms that use the standardised approach to credit risk, as opposed to those that used an internal ratings-based approach (see Chapter 3 in Appendix 2). This flexibility is explicitly recognised in the EBA guidelines, and the PRA proposes to make use of it to ensure that firms using the standardised approach (which tend to be the smaller institutions in the firm population) are not inherently disadvantaged by the calculation methodology.

Equality and diversity

3.10 The PRA may not act in an unlawfully discriminatory manner. It is required, under the Equality Act 2010, to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out its policies, services and functions.² To meet this requirement, the PRA has performed an assessment of the policy proposals and does not consider that the proposals give rise to equality and diversity implications.

1 Section 138K of FSMA.

2 Equality Act 2010, section 149(1).

Appendices

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- 1 PRA Rulebook: Depositor Protection Instrument 2016 (PRA2016/xx)**
 - 2 Draft Statement of Policy – Calculating risk-based levies for the Financial Services Compensation Scheme deposits class**
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Appendix 1

PRA RULEBOOK: CRR FIRMS, NON CRR FIRMS, NON-AUTHORISED PERSONS: DEPOSITOR PROTECTION INSTRUMENT 2016

Powers exercised

- A. The Prudential Regulation Authority (“PRA”) makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 137G (The PRA’s general rules);
 - (2) section 137T (General supplementary powers);
 - (3) section 213 (The compensation scheme); and
 - (4) section 214 (General).
- B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instrument) of the Act.

Pre-conditions to making

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

PRA Rulebook: CRR Firms: Non CRR Firms, Non-Authorised Persons, Depositor Protection Instrument 2016

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

Commencement

- E. This instrument comes into force on [DATE].

Citation

- F. This instrument may be cited as the PRA Rulebook: CRR Firms, Non CRR Firms, Non-Authorised Persons: Depositor Protection Instrument 2016.

By order of the Board of the Prudential Regulation Authority

[DATE]

Annex

Amendments to the Depositor Protection Part

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

34 FUNDING - DGS COMPENSATION COSTS LEVY

...

34.4 *DGS compensation cost levies* imposed on *DGS members* to raise the *available financial means* of the *deposit guarantee scheme* must be based on the amount of *covered deposits* (excluding *temporary high balances*) and the FSCS's assessment of the degree of risk incurred by the respective *DGS member*.

[Note: Art. 13(1) of the *DGSD*]

...

36 FUNDING - LEGACY COSTS LEVY

...

36.5 The FSCS must calculate each *DGS member's* share of a *legacy costs levy* by:

- (1) identifying the *legacy costs* allocated to *class A*;
- (2) calculating the *DGS member's class A tariff base* as a proportion of the total *class A tariff base* of all *DGS members* (excluding *Northern Ireland credit unions*), using the *statement of business* most recently supplied;
- (3) applying the proportion calculated in (2) to the figure in (1); and
- (4) applying an adjustment for the degree of risk incurred by the *DGS member* to the product of the calculation in (3).

36.6 *Legacy cost levies* must be based on the amount of *covered deposits* (excluding *temporary high balances*) and the FSCS's assessment of the degree of risk incurred by the respective *DGS member*.

...

39 FUNDING - BUSINESS ACQUISITIONS FROM DGS MEMBERS

...

39.2 If:

- (1) a *DGS member* (A) assumes a liability to repay *deposits* held by another *DGS member* (B);
- (2) B is no longer liable to pay a *DGS levy* to the FSCS; and
- (3) the assumption of liability takes place after the date to which, or as of which, A's most recent *statement of business* is drawn up,

the *FSCS* must require A to pay an additional amount equal to the levy that would have been payable by B in relation to the relevant business and *class A* (including an adjustment for the *FSCS*'s assessment of the degree of risk incurred by B) if the acquisition had not taken place and B had remained liable to pay *DGS levies*. The amount is based on the B's most recent *statement of business*.

...

42 FUNDING - DGS COMPENSATION COSTS

...

42.3 The *FSCS* must calculate each *DGS member's* share of a *DGS compensation costs levy* by:

- (1) identifying the *DGS compensation costs* allocated to *class A*;
- (2) calculating, in relation to *class A*, the *DGS member's* tariff base as a proportion of the total tariff base of all *DGS members* in *class A*, using the *statement of business* most recently supplied;
- (3) applying the proportion calculated in (2) to the figure in (1); and
- (4) applying an adjustment for the degree of risk incurred by the *DGS member* to the product of the calculation in (3).

...

Appendix 2: Draft Statement of Policy - Calculating risk-based levies for the Financial Services Compensation Scheme deposits class

1 Introduction

1.1 This statement of policy (SoP) sets out the calculation methodology that the Prudential Regulation Authority (PRA) uses, as the UK's designated authority in respect of the Deposit Guarantee Scheme (DGS),¹ to calculate the risk-adjustment for DGS member contributions to the Financial Services Compensation Scheme (FSCS).

1.2 This methodology will apply to the calculation of both compensation cost and legacy cost levies. All references to 'levies' or 'contributions' that follow should be read as applying equally to both types of levies.

1.3 This SoP is intended to be read together with the rules governing the funding of the FSCS in the Depositor Protection Part of the PRA Rulebook, and the sections relating to the role of the FSCS in funding the DGS in the 'Statement of Policy – Deposit Guarantee Scheme',² which applies to the FSCS. Readers may also wish to refer to the European Banking Authority (EBA) guidelines on risk-based contributions,³ upon which the PRA's methodology is based.

2 The risk-based levy calculation formula

2.1 As per Depositor Protection 36.5 and 42.3, the FSCS is required to calculate firm levies using the following formula:

$$\text{Levy} = \text{Total levy} * \frac{\text{Firm class A tariff base}}{\text{Total class A tariff base}} * \text{Risk adjustment factor}$$

2.2 The risk-adjustment factor is composed of the member's aggregate risk weight (ARW), multiplied by an adjustment factor (μ). The ARW for each member will be determined by the PRA (see Chapter 3) and provided to the FSCS. The FSCS will compute μ , which is the same for all DGS members in a given year (see Chapter 4), and calculate each member's levy.

2.3 The PRA will calculate the ARW for each DGS member using the following formula:

$$ARW_i = 75\% + 75\% * (1 - \log_{10}(10 - 9 * ARS_i))$$

2.4 The ARW for each firm will range from 75% - 150%, which is the minimum range specified in the EBA guidelines. The PRA considers that this provides a sufficient degree of risk differentiation between firms. The ARW for each DGS member depends uniquely on the member's aggregate risk score (ARS). The next chapter sets out the calculation methodology for the ARS.

1 4(1) of the Deposit Guarantee Schemes Regulations 2015;
http://www.legislation.gov.uk/uksi/2015/486/pdfs/uksi_20150486_en.pdf.

2 'Statement of Policy – Deposit Guarantee Scheme';
<http://www.bankofengland.co.uk/pru/Pages/publications/sop/2015/fscsdgsupdate.aspx>.

3 'Guidelines on methods for calculating contributions to deposit guarantee schemes';
https://www.eba.europa.eu/documents/10180/1089322/EBA-GL-2015-10_GL+on+Calculation+of+Contributions+DGS.pdf/92da0adb-3e16-480f-8720-94f744ea7a44.

3 Calculating the Aggregate Risk Score

Capital Requirements Regulation (CRR) firms

3.1 For a DGS member that is a CRR firm,¹ the calculation of the ARS will be based on the following risk indicators:

Risk indicator	Weight
Leverage ratio	12%
Common Equity Tier 1 (CET1) Ratio	12%
Liquidity coverage ratio (LCR)	24%
Non-performing loans (NPL) ratio	18%
Risk-weighted assets/Total assets	8.5%
Return on assets (RoA)	8.5%
Unencumbered assets/covered deposits	17%
Total	100%

3.2 Each DGS member will be attributed an individual risk score (IRS) for each risk indicator (calibrated as in paragraph 3.4). The IRS for each risk indicator will then be weighted as in the table above, to arrive at the ARS for each DGS member that is a CRR firm.

3.3 Unless otherwise specified, all calculations are performed on each DGS member on a solo-consolidated/unconsolidated basis, and terms used are as defined in the CRR.² To calculate the values of the risk indicators, the PRA will use:

- for income statement measures, the value as at (or closest to) 31 December of the preceding year (so the July 2017 levy will use data that firms report as at 31 December 2016); and
- for balance sheet measures, the average value at (or closest to) 31 December of the two preceding years (so the July 2017 levy will use data that firms report as at 31 December 2016 and 31 December 2015).

3.4 The PRA will use the following calibration scales to attribute IRSs for each risk indicator for each DGS member that is a CRR firm in each levy cycle:

(i) Leverage ratio

Bucket	≤3%	>3%
IRS	100	0

The leverage ratio will be calculated as the ratio of Tier 1 Capital to total assets,³ until the leverage ratio as defined in the CRR is fully operational.

¹ A UK bank, a building society or a UK designated investment firm.

² The Capital Requirements Regulation (575/2013).

³ Defined as the sum of fields 20A and 20B as firms are required to report in form FSA001.

(ii) Common Equity Tier 1 ratio (CET1 ratio)

Bucket	≤7%	>7%
IRS	100	0

CET1 ratio will be calculated as the ratio of CET1 capital to risk-weighted assets.¹

(iii) Liquidity coverage ratio (LCR)

For the purposes of a levy to be raised in 2017:

Bucket	≤90%	>90%
IRS	100	0

For all subsequent levies:

Bucket	≤100%	>100%
IRS	100	0

Where DGS members have received a waiver from the PRA from meeting liquidity requirements on a solo basis pursuant to Article 8 of the CRR, the LCR risk indicator will be calculated (and calibrated) at the level of the relevant liquidity sub-group.

(iv) Non-performing loans (NPL) ratio

Bucket (by percentile rank)	0 – 20 th	20 th – 40 th	40 th – 60 th	60 th – 80 th	80 th – 100 th
IRS	0	25	50	75	100

NPL ratio will be calculated as the ratio of Non-performing loans² to total loans.³

(v) Risk-weighted assets (RWA)⁴/total assets⁵

Bucket (by percentile rank)	0 – 20 th	20 th – 40 th	40 th – 60 th	60 th – 80 th	80 th – 100 th
IRS	0	25	50	75	100

DGS members that use the internal ratings-based (IRB) approach for calculating minimum own funds requirements will be ranked separately to those DGS members that use the standardised approach. In the calculation of the IRS for this risk indicator, DGS members using the standardised approach will not be rated relative to those using the IRB approach (and vice versa).

(vi) Return on assets (RoA)

Bucket (by percentile rank)	0 – 20 th	20 th – 40 th	40 th – 60 th	60 th – 80 th	80 th – 100 th
IRS	100	75	50	25	0

1 Defined as the 'total risk exposure amount', as defined in the CRR.

2 Defined as the sum of the following fields as firms are required to report in form FSA015: 11G, 11Q, 20B, 20D, 23B, 23D, 26B, 26D, 31B, 31C.

3 Defined as field 32H as firms are required to report in form FSA015.

4 Defined as in (1) above.

5 Defined as the sum of fields 20A and 20B as firms are required to report in form FSA001.

RoA will be calculated as the ratio of net income¹ to total assets,² and averaged over two years.

DGS members that are building societies will be ranked and rated separately to other DGS members. In the calculation of the IRS for this risk indicator, building societies will not be rated relative to banks (and vice versa).

(vii) Unencumbered assets/covered deposits

Bucket	≤1	1 – 2	>2
IRS	100	50	0

This indicator is defined as the ratio of total assets less encumbered assets³ to covered deposits.⁴

Credit unions

3.5 For a DGS member that is a credit union, the calculation of the ARS will be based on the following risk indicators:

Risk indicator	Weight
Leverage ratio	25%
Liquidity ratio	25%
Non-performing loans (NPL) ratio	25%
Return on assets (RoA)	25%
Total	100%

3.6 Similar to the approach taken for CRR firms in paragraph 3.2, the PRA will calculate an IRS for each indicator for each DGS member that is a credit union, as calibrated in paragraph 3.8. These IRSs will be weighted as per the table above to derive the ARS.

3.7 To calculate the values of the risk indicators, the PRA will use:

- for income statement measures, the value as of the annual return (Form CY) the credit union was required to submit in the preceding year (so the July 2017 levy will use data that firms report in 2016); and
- for balance sheet measures, the average value using the Form CY returns submitted over the two preceding years (so the July 2017 levy will use data that firms report in 2016 and 2015).

3.8 The PRA will use the following calibration scales to attribute IRSs for each risk indicator for each DGS member that is a credit union in each levy cycle:

1 Defined as the sum of the following fields as firms are required to report in form FSA002: 2B, 7B, 23B; less the sum of the following fields as firms are required to report in form FSA002: 26B, 32B, 33B, 38B, 39B.

2 Defined as the sum of fields 20A and 20B as firms are required to report in form FSA001.

3 As defined in the EBA guidelines on disclosure of encumbered and unencumbered assets; <https://www.eba.europa.eu/documents/10180/741903/EBA-GL-2014-03+Guidelines+on+the+disclosure+of+asset+encumbrance.pdf/c65a7f66-9fa5-435b-b843-3476a8b58d66>.

4 Defined as the class A tariff base, as defined in the Depositor Protection Part of the PRA Rulebook.

(i) Leverage ratio

Bucket	≤5%	5 – 10%	>10%
IRS	100	50	0

Leverage ratio will be calculated as the ratio of total reserves¹ to total assets.²

(ii) Liquidity ratio

Bucket	≤10%	10 – 15%	>15%
IRS	100	50	0

Liquidity ratio will be calculated as the ratio of liquid assets³ to total assets.⁴

(iii) Non-performing loans (NPL) Ratio

Bucket (by percentile rank)	0 – 20 th	20 th – 40 th	40 th – 60 th	60 th – 80 th	80 th – 100 th
IRS	0	25	50	75	100

NPL ratio will be calculated as the ratio of total net liabilities in arrears⁵ to total net liabilities.⁶

(iv) Return on assets (RoA)

Bucket (by percentile rank)	0 – 20 th	20 th – 40 th	40 th – 60 th	60 th – 80 th	80 th – 100 th
IRS	100	75	50	25	0

RoA will be calculated as the ratio of profit/loss after tax⁷ to total assets.⁸

Non-EEA branches

3.9 For a DGS member that is a non-EEA branch (ie an overseas firm that is not an incoming firm), the PRA will attribute an ARS of 50.

Other provisions

3.10 If, at any point, the PRA is unable to calculate the ARS for any DGS member in line with the methodology stated in this Chapter (for example, if a DGS member has failed to make a regulatory data submission), the PRA will attribute that DGS member with the highest ARS of 100. This is separate to the provisions of Depositor Protection 44.4, which applies if a firm does not submit a complete statement of business (measured in accordance with the class A tariff base) to the FSCS in accordance with Depositor Protection 44.2.

4 Calculating the risk-based levy

4.1 The PRA will attribute all DGS members with an ARS, as per the methodology in Chapter 3. The ARS for each firm will be translated into an ARW ranging between 75-150%, as specified by the formula in 2.3. The PRA will provide this data to the FSCS.

1 Defined as the sum of the following fields as firms are required to report in Form CY: 2N, 2P, 42C, 42D

2 Defined as the field 1P as firms are required to report in Form CY.

3 Defined as the field 29E as firms are required to report in Form CY.

4 Defined as in (2) above.

5 Defined as the field 15CL as firms are required to report in Form CY.

6 Defined as the field 14H as firms are required to report in Form CY.

7 Defined as the field 7 as firms are required to report in Form CY.

8 Defined as in (2) above.

4.2 The adjustment factor μ will be calibrated in each levy cycle to ensure the exact levy target is reached. For example, for a levy target of £80million:

DGS member	Class A tariff base share	ARW	Unadjusted risk-based levy (share*ARW*£80million)	Risk-based levy post-adjustment factor ($\mu=0.8$)
Firm A	10%	100%	£8million	£6.4million
Firm B	50%	110%	£44million	£35.2million
Firm C	40%	150%	£48million	£38.4million
Total			£100million	£80million

4.3 Were there to be no further adjustment, the total industry levy would exceed the levy target. The adjustment factor μ would then be set here as $80/100(=0.8)$, and each DGS member's levy reduced proportionately by this factor to ensure the levy target (and only this amount) is levied.

4.4 In each levy cycle, the PRA will provide the FSCS with the ARW for each DGS member. The FSCS will use this information and the class A tariff base data to determine the adjustment factor μ , and then calculate the risk adjustment factor (paragraph 2.2). The FSCS will then apply this factor to calculate each member's risk-based levy, in accordance with Depositor Protection 36.5 (for legacy cost levies) and 42.3 (for compensation cost levies).

