Policy Statement | PS28/17

PRA fees and levies: model transaction fees, fees and FSCS levies for insurers and fees for designated investment firms

December 2017

BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

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1 Overview

1.1 This Prudential Regulation Authority (PRA) policy statement (PS) provides feedback to responses to Consultation Paper (CP) 16/17 'PRA fees and levies: model transaction fees, fees and FSCS levies for insurers and fees for designated investment firms'.[1]

1.2 It sets out final rules intended to:

- introduce a new approach for determining periodic fees for designated investment firms (DIFs) in the A10 fee block;
- introduce a new approach for determining periodic fees for general insurers and life insurers in the A3 and A4 fee blocks respectively;
- introduce a new approach for determining Financial Services Compensation Scheme (FSCS) levies for insurance firms falling within FSCS levy classes B1 (general insurance) and C1 (life and pensions);
- amend an error in the rules concerning the criteria for determining model application fees under CRR;[2]
- change the criteria for determining model application fees for DIFs and insurers; and
- introduce a model maintenance fee for firms with Solvency II[3] or CRR models.

1.3 The final rules are included in the appendices to this PS.

1.4 This PS is relevant to insurers and DIFs, as well as firms that have, or intend to apply in the future for, Solvency II or CRR models. The proposals relating to FSCS levies are relevant to insurance firms falling within FSCS levy classes B1 (general insurance) and C1 (life and pensions), the FSCS Ltd as scheme manager, the Society of Lloyd's and policyholders.

1.5 The PRA received eleven responses to the CP. The chapters below are structured in the same format as the CP. They provide the PRA's feedback to responses and its final decisions.

Statutory obligations

1.6 Where the final rules differ from the draft in the CP in a way which is, in the opinion of the PRA, significant, the Financial Services and Markets Act 2000 (FSMA)[4] requires the PRA to publish:

(a) details of the difference together with a cost benefit analysis; and

(b) a statement setting out in the PRA's opinion whether or not the impact of the final rule on mutuals is significantly different to: the impact that the draft rule would have had on mutuals; or the impact that the final rule will have on other PRA-authorised firms.

1.7 There are five changes from the proposals contained in the CP, these are summarised below with further detail provided in the following chapters. The PRA has:

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1 www.bankofengland.co.uk/prudential-regulation/publication/2017/pra-fees-and-levies.
2 Capital Requirements Regulation (575/2013) (CRR).
3 Solvency II Directive (2009/138/EC) (as amended).
4 Section 138J(5) and 138K(4).

- decided not to change the relative composition of premiums and liabilities in the fee calculations for general and life insurance firms in the A3 and A4 fee blocks at this stage;
- modified the definition of gross best estimate liabilities for fees purposes (BEL);
- introduced a lower band for the Solvency II model maintenance fee;
- amended the basis on which the Solvency II model maintenance thresholds are calculated; and
- amended the model maintenance fee rules to exclude the Society of Lloyd's and keep the cost of maintaining the Society of Lloyd's Solvency II model within its fee block.

1.8 The PRA is exempt from having to carry out a cost benefit analysis on its draft fees rules.[1] Where these changes have consequent effects on FSCS levies, the PRA does not consider these changes significant enough to have any additional material impact on firms, and so has not provided an updated cost-benefit analysis.

1.9 The PRA does not consider that the changes to the rules have a significant impact on mutuals, or are significantly different to the impact they will have on other PRA-authorised firms.

2 Periodic fees

Designated investment firms

2.1 The PRA received no responses to its proposals for a new approach for calculating periodic fees paid by DIFs in the A10 fee block. As a result, the PRA will implement the rules as set out in the CP.

Insurance firms

Composition between premiums and liabilities

2.2 In Chapter 2 of the CP, the PRA set out proposals for changing the relative composition between premium income and liabilities for determining periodic fees for both general insurers and life insurers. The PRA invited views from firms on possible alternative weightings in recognition that the arguments for different approaches were finely balanced.

2.3 Comments from respondents on the specific weighting options were generally neutral, partly reflecting the fact that some firms will see fee rises from any change in weightings while other firms will see lower fees. Two respondents noted that recent experience suggested newer, faster-growing insurers (with relatively high annual premium income to liabilities) had recently proved riskier than established insurers (with relatively high liabilities to annual premium income). One respondent asked for more analysis of the impact of the changes on different groups of firms. Another respondent said that it would be significantly adversely affected by the change.

2.4 Three respondents said that the PRA should carry out a more wide-ranging review of approaches for allocating fees across firms before making any changes to the weightings, noting that the PRA had already signalled an intention to review fees for different types of life business. Suggestions included a more granular approach that more closely matched fees to how the PRA allocates supervisory resources to each firm, including utilising the PRA's

1 Section 138J(6)(d) of FSMA.

categorisation of firms. One respondent said the PRA should take a non-linear approach for determining fees for insurers, so that costs were further weighted away from – or capped for – smaller firms.

2.5 In light of these comments and to be able to fully consider the suggestions made, the PRA has decided not to change the relative composition of the fee inputs for general insurance or life insurance firms (either Directive or non-Directive firms) at this stage. Rather, it will look further at options for determining the allocation of fees to insurers with the intention of consulting on updated proposals in 2018/19.

Internal reinsurance and back-book transactions

2.6 Three respondents said that group internal reinsurance (where one PRA-regulated entity reinsures another PRA-regulated entity within the same group) could lead to 'double counting' and fees disproportionate to PRA costs. This, it was said, could give an advantage to groups with internal foreign-domiciled reinsurers and incentivise more complex group structures. One respondent suggested using a different approach for internal reinsurance or a lower rate. Another respondent proposed using premium and liabilities net of reinsurance ceded.

2.7 Two of these respondents also raised concerns about the treatment of large back-book transactions (such as bulk annuity transfers and quota share reinsurance of blocks of existing business) which can generate large 'one-off' reinsurance premiums, and therefore fees, which could be disproportionate to the costs incurred by the PRA.

2.8 Having reviewed the responses, the PRA continues to consider that regular internal group reinsurance should not be treated differently in the fee calculation. This reflects the fact that: such transactions can generate risks to the PRA's objectives as well as supervisory work for the PRA; making adjustments could favour some forms of reinsurance over others and incentivise firms to change behaviours; it could result in relief being granted to reinsurance of business conducted outside of the United Kingdom; and it would add complexity to the fees rules, which are intended to be a broad proxy of the amount of work for the PRA. The PRA also considers it important to minimise the reporting burden on firms: given that internal reinsurance is not separately identified on Solvency II returns, it would not be possible to systematically treat internal reinsurance differently in the fees calculation without requiring additional reporting by all firms.

2.9 However, the PRA recognises that there is a risk of a disproportionately high fee being generated for some large 'one-off' transactions involving reinsurance of back books. As well as resulting in large fees for some firms in some years, such one-off transactions could lead to significant volatility in fees for other firms.

2.10 To deal with the impact of potential 'one-off' transactions, the PRA intends to use existing provisions in the Rulebook[1] that give it discretion to reduce a fee payment in exceptional circumstances if it would be inequitable to require the payment. To help ensure this is done consistently and fairly, an insurer should inform the PRA[2] by end-February if it has undertaken a transaction (such as a large bulk annuity transfer) in the previous calendar year that it would like taken into consideration when calculating its fee and provide relevant details. Submissions will be considered on a case-by-case basis but relief would be expected to be

1 Fees 2.9.
2 By contacting its PRA supervisor.

granted only for exceptional transactions that could have an unusually large and inequitable impact on a firm's fee.[1]

General insurers

2.11 For Solvency II general insurers, it was proposed that the determinants for calculating fees should be changed to gross written premium for fees purposes (GWP) and BEL, using data from Solvency II returns.

2.12 No respondents disagreed with the proposal to use GWP and BEL as the two fee inputs, however, one respondent suggested an alternative definition for BEL based on a firm's total best estimate – gross liabilities and its gross best estimate of annuities stemming from non-life, which it claimed would be simpler and reduce the risk of anomalous outcomes. The PRA agrees partly with the respondent's proposal relating to non-life annuities as this would be simpler while achieving a similar outcome, and has therefore changed the definition of BEL for fees purposes from:

- S.12.01.01, rows (R0010 + R0230 + R0260), columns (C0090 + C0190) + S.12.01, rows (R0010 + R0030), column C0140 + S.17.01.01, rows (R0010 + R0370 + R0380 + R0410 + R0420), column C0180

to:

- S.12.01.01, rows (R0010 + R0030), columns (C0090 + C0140 + C0190) + S.17.01.01, rows (R0010 + R0370 + R0380 + R0410 + R0420), column C0180

2.13 The PRA has not taken on board the rest of the proposed change[2] because there is no directly equivalent concept to total best estimate – gross liabilities for non-directive firms, potentially creating an inconsistent treatment across firms within the same fee block. The PRA will look carefully at future fees to ensure the definition of BEL does not result in anomalous outcomes.

2.14 Some minor amendments have been made to the definition of BEL to clarify its intended scope.

Non-Directive general insurance firms

2.15 Chapter 2 of the CP proposed that the fee for 'non-Directive' (non-Solvency II) general insurance firms should be based on premium and liabilities derived from existing regulatory returns. One respondent supported this proposal.

Friendly societies

2.16 The PRA proposed that fees for Directive friendly societies should be based on the same approach and data as other Solvency II firms. One respondent supported this proposal.

2.17 The PRA also proposed that the fees calculation approach for non-Directive friendly societies should be aligned with that for other non-Directive firms, utilising existing reported balance sheet data. One respondent supported this proposal provided the PRA ensured that only activity relating to regulated activity was captured. The PRA can confirm that the intention is to capture regulated-activity only for fees purposes. Where this is not clear from submitted returns, individual firms may be asked to provide additional information.

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1 The PRA intends to consult on updating SS3/16 to reflect this approach.
2 Replacing 'S.17.01, rows (R0010 + R0370 +R0380 +R0410 +R0420), column C0180" with "S.17.01, row R260, column C0180'.

Minimum thresholds

2.18 In Chapter 2 of the CP, the PRA proposed to change the metrics for determining the minimum thresholds for paying periodic fees to GWP and BEL. No comments were received on this proposal.

Life insurers

2.19 For Solvency II life insurers, the PRA proposed that the determinants for calculating fees should be changed to GWP and BEL, excluding business related to corporate pensions in both cases, using data from Solvency II returns.

2.20 No respondents disagreed with the use of GWP and BEL for determining fees for life insurers. One respondent supported the change from adjusted gross premium income (AGPI) to GWP but noted that it could impact on some firms, given the specific composition of their business, and asked the PRA to ensure it had analysed the impact on individual insurers and particularly smaller insurers.[1]

2.21 The PRA considers GWP to be the best 'premium-based' measure of firm activity and size and therefore a suitable proxy for the risks that a firm poses to its objectives. It would be inappropriate to use a directly equivalent measure to AGPI given that the concept of AGPI is no longer used in the sector and continuing to use it could result in some firms paying disproportionate levels of fees. The exact impact of the change from AGPI to GWP on an individual firm will depend both on the composition of its business and the aggregate levels of GWP reported by the sector, which will vary from year to year but is not expected to impact smaller firms or mutuals any more than other groups of firms. The PRA will monitor carefully the impact of the change from the AGPI to GWP to ensure it results in firms paying appropriate fees.

2.22 One respondent said that there should be a different approach for allocating fees to firms which carry out unit-linked business given what they perceived to be the lower impact of this business on the PRA's objectives. The PRA will consider the treatment of unit-linked business as part of its review of fees for different types of life business, planned for 2018/19.

2.23 One respondent said that the proposal to deduct 'corporate pension funds' (as set out in paragraph 2.31 of the CP) from the fees calculation for life insurers should be extended to include trustee investment products, as is the case under the current rules. The PRA can confirm that the intention is to exclude trustee investment products from the fees calculation and that the definitions (as set out in the rules) are intended to achieve this.

2.24 The PRA proposed that 'non-Directive' life insurance firms should be exempt from the PRA's periodic fees apart from the minimum fee. In the light of this change, it was also proposed that the 11% discount to the periodic fee paid by non-Directive life insurers would no longer apply. One respondent said that the 11% discount should be reinstated. However, as the 11% discount no longer has any effect (given that non-Directive life insurers will already be receiving a 100% discount on their periodic fees, apart from the minimum fee), it will be deleted from the rules.

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1 The main differences between AGPI and GWP are the treatment of 'regular' premium and business transacted through independent practitioners or tied agents. To determine, AGPI 'regular premium business' is multiplied by 10, whereas for GWP it is treated the same as single premium business. For AGPI, business transacted through independent practitioners or tied agents is divided by two, whereas this is not the case for GWP. In addition, premiums relating to reinsurance of life business are now captured within the life insurance fee block rather than the general insurance fee block.

Insurance fee data

2.25 In Chapter 2 of the CP, the PRA set out proposals to utilise existing regulatory returns (where possible) for calculating PRA fees rather than requiring additional reporting. This approach was supported by two respondents.

2.26 Chapter 2 also noted that the window between Solvency II annual returns being submitted to regulators and fees needing to be calculated and invoiced to firms was short, limiting the PRA's ability to carry out data quality work. The PRA therefore proposed that it should be able to use data from the previous year for calculating fees in 2018/19 for individual insurers, where applicable, if full confidence in the latest data could not be achieved.

2.27 Two respondents suggested that the PRA should delay the timetable for calculating tariff data and issuing invoices to avoid having to use previous years' data. The PRA agrees that delaying the invoicing of firms for a short period may be an option to deal with some data issues. However, the PRA believes it is necessary to maintain the flexibility to be able to use previous data, in the unlikely event that data issues cannot be resolved and invoices cannot be delayed further.

3 FSCS levies

3.1 In Chapter 3 of the CP, the PRA proposed to update the metrics for the calculation of levies for the FSCS following the introduction of the Solvency II regime. Two responses related to FSCS levies; no respondents disagreed with the substance of the proposals.

3.2 One respondent requested clarification on the application of proposed rules for corporate pension fund management. To maintain consistency with the approach for PRA Fees, relevant net premium income and eligible liabilities are calculated in accordance with the method applicable to the firm for calculating 'gross written premium for fees purposes' and 'eligible liabilities for Fees purposes' in Fees 1.2 and Fees 3.4 (3)(c), with the adjustments detailed in Annex 2, which are (inter alia) intended to ensure that pension fund management business is not excluded from the calculation of FSCS levies for long-term insurers, in line with the current approach.

3.3 One respondent highlighted a minor error in the transposition of the rules made previously in the Compensation Sourcebook of the PRA Handbook into the PRA Rulebook following legal cutover regarding the definition of 'occupational pension fund management business' for the purposes of the PRA Rulebook – Policyholder Protection Part. The PRA intends to consult on the correction of this error in a future PRA consultation paper.

4 Regulated transaction fees: model approaches

Model applications under CRR

4.1 In Chapter 4 of the CP, the PRA proposed to correct errors in the thresholds of Table D of Chapter 4 of the Fees rules, used to determine the size of a model application fee and to clarify the wording of the first threshold so that the fee will be applicable when there are 'five or more significant overseas entities' within the scope of an application rather than just present in a group. The PRA received no responses to its proposals. As a result, no changes have been made to the draft rules in these areas.

Model applications by designated investment firms (DIFs)

4.2 The PRA proposed to change the basis for determining model application fees for DIFs so that they would no longer reference the number of traders employed by a firm. Instead, for

DIFs with four or fewer significant overseas entities within the same group application, the fee would be determined by the size of that firm's total trading assets. The PRA received no responses to its proposals. As a result, no changes have been made to the draft rules in these areas.

Model maintenance fee

4.3 Chapter 4 of the CP proposed to introduce an annual 'model maintenance' fee, chargeable to firms with a CRR or Solvency II internal model that attracts a transaction fee for a new application. UK firms relying on such a model that has been approved by another EU competent authority as part of a joint decision would also be subject to the fee.

4.4 Four respondents agreed with the proposals in principle. However, there was concern that the amounts proposed for Solvency II models could be disproportionately high for some smaller firms and firms with simpler models, and that this could be a barrier to model use. Respondents suggested that thresholds should be more granular by firm size and reflect the complexity of the model and category of firm. One respondent also noted that a number of models were being developed in relation only to premium risk, whereas the proposed scalar was based on liabilities. No responses on the model maintenance fee were received from CRR firms.

4.5 The proposed approach for determining the model maintenance fee is intended to be an approximation of the PRA resources required to maintain a model. It is not practical to differentiate for all types risk without introducing unworkable levels of complexity into the rules and higher costs. However, the PRA recognises that its proposed two bands for Solvency II models could result in some smaller firms potentially being subject to the higher fee. Therefore, the PRA has amended the draft Rules to introduce a lower band for Solvency II models that is expected to capture the smallest firms; this amendment will also further mitigate any risk that the model maintenance fee could be a barrier to model use.

4.6 The PRA has also amended the basis on which the Solvency II model maintenance fee thresholds are calculated so that they reflect both premiums and liabilities. The thresholds are now based on the sum of a firm's GWP for fees purposes and BEL for fees purposes. Group models will be based on the aggregate sum of GWP and BEL for all PRA regulated firms using the model.

4.7 The new bands and thresholds are set out in the final rules contained in Appendix 2.

4.8 The PRA intends to consult on equivalent changes to the rules for model application fees for insurers next year.

4.9 In the light of a comment received, the PRA has also amended the draft rules so that the costs of maintaining the Society of Lloyd's model continue to be included in its periodic fee rather than a separate model maintenance fee. This reflects the fact that the Society of Lloyd's has its own fee block which already includes an allocation for model maintenance costs. Applying the model maintenance fee to the Society of Lloyd's would therefore introduce complexity to the fee rules without changing the fee it pays.

4.10 One respondent suggested that work to review the PRA's approach to model change should be completed before the model maintenance fee is introduced as resultant changes could significantly change the costs to the PRA. This work has yet to be consulted on and is unlikely to have a significant impact on the PRA's model maintenance resource requirements. Additionally, while model change is a significant part of the model maintenance fee, as set out

in the CP,[1] it is not the only part. The PRA will keep the cost of model maintenance under review and should these costs change significantly, it will consult on amending the fee.

4.11 One respondent said there was a risk that a model maintenance fee could become a factor in influencing an insurer's decision to seek model approval, which would go against the spirit of the Solvency II Directive. The PRA notes that the model maintenance fee will help to ensure firms that generate PRA costs pay those costs and has chosen model applications and maintenance fees to avoid the implicit disincentive resulting from the alternative of a model update leading to a regulatory fee. The PRA does not consider the model maintenance fee to be inconsistent with Solvency II Directive requirements and notes that other European financial regulators have model charging structures in place.

4.12 One respondent said that the model maintenance fee should be accompanied by clear service standards relating to model change including coordination of supervisory colleges. The Solvency II UK statutory instruments already require that any model application including model change and changes to model change policies should be determined within six months of receipt of that application. The PRA does not propose to introduce any additional requirements at this time.

4.13 One respondent asked for additional clarity about the methodology that would be used to split the fee for a group model across the firms in the group. In most case the PRA expects the fee to be paid by the firm that pays the highest period fee of those firms relying on the model; however it retains discretion to take another approach if it deems it appropriate to do so.

1 The fee covers specialist technical, supervisory and legal resources for work for ongoing model reviews as required under CRD1 Article 101 and Solvency II Directive Articles 36, 116 and 120; engagement with the European Banking Authority (EBA) on hypothetical portfolios for banking models; and model change applications.

Appendices

1	**PRA RULEBOOK: PRA FEES AMENDMENT INSTRUMENT 2017, available at: www.bankofengland.co.uk/prudential-regulation/publication/2017/pra-fees-and-levies.**
2	**PRA RULEBOOK: PRA FEES: MODEL TRANSACTION FEES, FEES FOR INSURERS AND DESIGNATED INVESTMENT FIRMS INSTRUMENT 2017, available at: www.bankofengland.co.uk/prudential-regulation/publication/2017/pra-fees-and-levies.**
3	**PRA RULEBOOK: SOLVENCY II FIRMS, NON SOLVENCY II FIRMS, NON AUTHORISED PERSONS: POLICYHOLDER PROTECTION INSTRUMENT 2017, available at: www.bankofengland.co.uk/prudential-regulation/publication/2017/pra-fees-and-levies.**