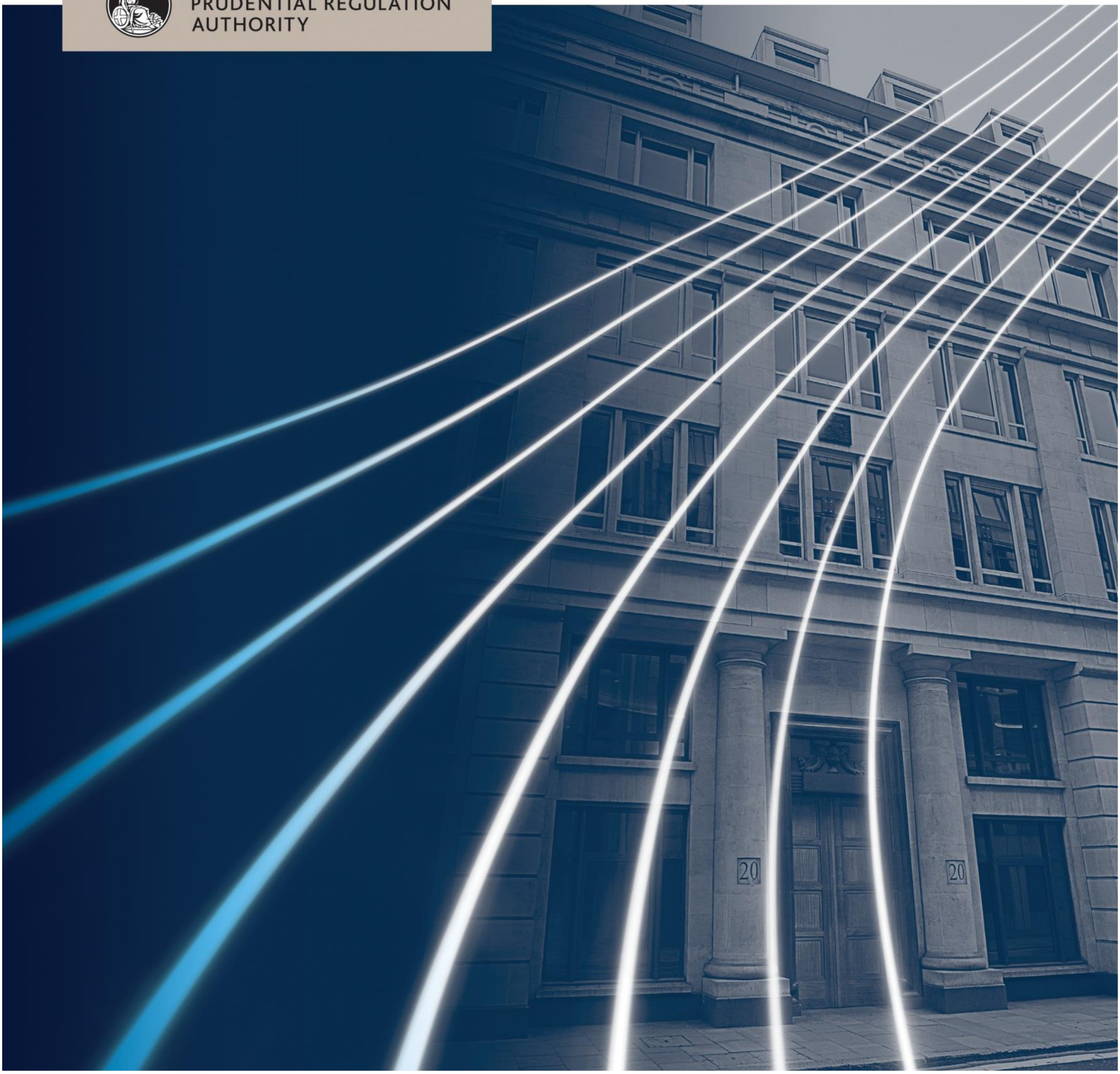
Policy Statement | PS6/17

Financial Services Compensation Scheme – Management Expenses Levy Limit 2017/18

March 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 the PRA Consultation Paper 1/17 'Financial Services Compensation Scheme – Management Expenses Levy Limit 2017/18' (the CP)[1] and final rules for the Financial Services Compensation Scheme (FSCS) Management Expenses Levy Limit (MELL) for 2017/18. It is relevant to all PRA authorised firms, but contains no material of direct relevance to retail financial services consumers or consumer groups upon which they might need to act.

1.2 The Financial Conduct Authority (FCA) board has also published its Handbook Notice, incorporating the 2017/18 MELL rules.[2]

1.3 The FSCS is the compensation fund of last resort for customers of failed authorised financial services firms across the PRA's and the FCA's regulatory remit. The MELL is the maximum amount which the FSCS may levy in a year without further consultation. It provides the FSCS with adequate resources to process compensation claims resulting from the failure of financial services firms. These functions are conferred on the FSCS by Part XV of the Financial Services and Markets Act 2000 (FSMA).

1.4 In the CP, the PRA and the FCA consulted on a proposed MELL of £74.5 million for 2017/18. This included:

- FSCS management expenses of £69.2 million to cover the FSCS's ongoing operating costs including staff, facilities, claims handling, and legal and other professional services; and
- an unlevied contingency reserve of £5.3 million which allows the FSCS to levy additional funds at short notice in the event of a significant unexpected event, without the need for further consultation by the PRA and the FCA.

1.5 The PRA does not consider that the responses to the CP raised issues which would lead to any alteration to the proposal and as such has made no material changes to the proposals consulted on in the CP.

1.6 The PRA is required by FSMA to publish a statement on the impact of rules on mutuals where the final rules differ from the draft of the proposed rule and a cost benefit analysis of any changes to the consultation proposals which the PRA considers to be significant.[3] The PRA has not done this, as the final rule does not differ from the draft rule consulted on.

1.7 Since consultation, the FSCS has increased its expected spending on bank charges by £300,000 as it has increased its commercial borrowing facility from £1.1bn to £1.3bn (see Chapter 3). The FSCS has confirmed that it will absorb the additional cost within the budget consulted upon and the PRA does not consider that the reallocation is material (representing 0.5% of the MELL). Therefore, the PRA has not provided an updated cost benefit analysis, and considers there to be no differential impact on mutuals.

1 January 2017: www.bankofengland.co.uk/pra/Pages/publications/cp/2017/cp117.aspx.
2 www.fca.org.uk/publications.
3 Sections 138J (5) and 138K FSMA.

2 Feedback to responses

2.1 The PRA is required by FSMA to have regard to any representations made to the proposals in a consultation, to publish an account, in general terms, of those representations and its response to them, and to publish details of any significant differences in the rules as made.[1]

2.2 There were four responses to the CP. Some respondents welcomed the reduction in FSCS management expenses, excluding outsourced claims handling costs, and the additional transparency provided in the FSCS's Plan and Budget.[2] Responses focussed on how the FSCS proposes to reduce claims handling costs, how the FSCS reprioritises spending within financial years, and increasing transparency over the FSCS's budget and activities.

Reduction of claims handling costs

2.3 Three respondents asked how the FSCS proposes to reduce claims handling costs and whether the FSCS's investment in systems maintenance and improvement (part of the Strategic Change Portfolio) is producing savings.

2.4 As indicated in the FSCS's Plan and Budget (and the CP), investment in the Strategic Change Portfolio has focussed on both improving customer service and delivering savings. As a result of recent investment, the FSCS forecasts £0.4 million of efficiency savings in 2017/18 and expected annual savings on like-for-like claim volumes of £5.0 million within three years.

2.5 The FSCS has advised that lower unit costs for claims handling will be achieved through improved arrangements with outsourcers, including a claims handling platform which can be accessed by both the FSCS and suppliers. The FSCS is reducing paper applications, and simplifying and automating the claims handling process. The FSCS has stated it will make 5% efficiency savings outside claims handling.

Reprioritisation of spending

2.6 One respondent asked how changing priorities within the Strategic Change Portfolio are identified and actioned.

2.7 The FSCS has advised that it has introduced a new process to release strategic change projects in quarterly cycles. Each release has a business case which includes resource and capability plans. Steering groups are held to track progress and a monthly Change Portfolio Board ensures projects are prioritised appropriately. As an example, in 2016/17, some of the funds allocated to the Strategic Change Portfolio were used to fund management expenses arising from unexpected EEA general insurance failures (Enterprise Insurance Company PLC and Gable Insurance AG). This was not planned at the beginning of the year.

Transparency of spending

2.8 Some respondents were concerned that the FSCS's Plan and Budget was vague on some areas of spending, particularly the Strategic Change Portfolio. One respondent also raised concerns over the transparency of the allocation of specific costs for FCA regulated firms.

2.9 The PRA agrees that transparency remains important, and the FSCS is aware that this is a priority for industry. The FSCS Plan and Budget includes further information on the allocation

1 Sections 138J(4) and (5) FSMA
2 www.fscs.org.uk/industry/publications/plan-and-budget/

of specific and base costs and the PRA will request further transparency from the FSCS in future years.[1]

3 Increase of the FSCS's commercial borrowing facility

3.1 After publication of the CP, the FSCS Board decided to increase the FSCS's commercial borrowing facility from £1.1 billion to £1.3 billion reflecting an increased borrowing headroom from recent recoveries and reduced interest costs on legacy debt. The FSCS is obliged to increase the facility under its agreement with HM Treasury which requires the FSCS's commercial funding capacity to be fully utilised before accessing the National Loans Fund. The PRA supports the larger credit facility as it reduces the likelihood of the FSCS calling on public funds during a payout.

3.2 The increase of the facility increases the costs of the FSCS's bank charges by £300,000. However, the overall MELL is unchanged as the FSCS has confirmed that it will absorb the increase within the management expenses budget consulted on. Given the management expense profile of the FSCS it is likely these costs will be absorbed across the core support, core (internal) claims handling and change expenditure lines. FSCS will provide regular updates to the industry as to the latest position against budget, through its industry publication Outlook.

1 www.fscs.org.uk/industry/publications/plan-and-budget/

Appendix

1 **PRA RULEBOOK: NON AUTHORISED PERSONS: FSCS MANAGEMENT EXPENSES LEVY LIMIT AND BASE COSTS INSTRUMENT 2017, available at www.bankofengland.co.uk/pra/Pages/publications/ps/2017/ps617.aspx**