BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

Publication

Policy Statement | PS5/21

Financial Services Compensation Scheme – Management Expenses Levy Limit 2021/22

March 2021

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Contents

1 Overview

1.1 This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to responses to Consultation Paper (CP) 4/21 'Financial Services Compensation Scheme - Management Expenses Levy Limit 2021/22'.[1] It also contains the final rules for the Financial Services Compensation Scheme (FSCS) Management Expenses Levy Limit (MELL) for 2021/22 (Appendix).

1.2 This PS 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.

Background

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 Financial Conduct Authority's (FCA's) regulatory remit. The MELL is the maximum amount that the FSCS may levy for management expenses in a year without further consultation. It provides the FSCS with the 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 CP4/21, the PRA and FCA consulted on a proposed MELL of £105.5 million for 2021/22. This included:

- FSCS management expenses of £90.5 million to cover the FSCS' ongoing operating costs including staff, facilities, claims handling, legal and other professional services; and
- an unlevied reserve of £15.0 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 and FCA additionally noted that the FSCS is taking a different approach to the use of the unlevied reserve this year. Under this approach, the unlevied reserve will be used to cover management expenses in relation to both a portion of forecasted claims and unexpected increases in claims, as a result of the difficulty in accurately predicting claims volumes due to the uncertainty of the current economic climate.

Summary of responses

1.6 The PRA received six responses to the CP that were relevant to the proposal consulted on. The PRA's feedback to these responses is set out in Chapter 2.

1.7 Three respondents commented on the MELL. Two respondents acknowledged the arguments for the increases on the MELL and the rationale behind the approach taken towards the unlevied reserve this year given the Covid-19 pandemic. One of these respondents questioned the necessity of the increases in the FSCS staff headcount. The third respondent criticised the overall increases in FSCS levies.

1.8 One of these respondents, and three others, raised specific concerns around the FSCS interim levies and FCA funding classes.

1 January 2021: https://www.bankofengland.co.uk/prudential-regulation/publication/2021/january/financial-services-compensation-scheme-management-expenses-levy-limit-2021-2022.

1.9 Having considered the responses to the CP, the PRA has decided to publish the policy as proposed.

Implementation

1.10 The FSCS MELL will apply for the financial year ending Thursday 31 March 2022.

1.11 The FCA Board has also made its respective rule for the 2021/22 MELL.[2]

1.12 The policy set out in this PS has been designed in the context of the UK having left the European Union and the transition period having come to an end. Unless otherwise stated, any references to EU or EU derived legislation refer to the version of that legislation which forms part of retained EU law.[3] The PRA will keep the policy under review to assess whether any changes would be required due to changes in the UK regulatory framework.

2 FCA Handbook Notice 86: https://www.fca.org.uk/publication/handbook/handbook-notice-86.pdf
3 For further information please see https://www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards.

2 Feedback to responses

2.1 Before making any proposed rules, the PRA is required by FSMA to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its feedback to them.[4]

2.2 The PRA received six responses to the consultation which related to the MELL. The section below has been grouped by the areas raised by respondents as follows:

- increases on the MELL;
- unlevied reserve;
- staff headcount; and
- FCA-related and other issues.

Increases on the MELL

2.3 The proposed MELL is an increase of £22.4 million (16%) from the 2020/21 MELL. Previous year-on-year increases of the MELL were 5% in 2020/21 and 2.6% in 2019/20.

2.4 The FSCS recognises that it needs to use its resources in the most economical and efficient way. It is committed to delivering a high level of service while keeping its costs as low as possible. Its partnership with Capita is an example of how it has saved money on claims handling.

2.5 Three respondents commented on the increases on the 2021/22 FSCS MELL. Two of these respondents acknowledged the arguments for the increases given the higher level of uncertainty, one of which set out that the increases were being made at a time when firms' incomes have reduced due to the Covid-19 pandemic. The third respondent criticised the overall increases in FSCS levies.

2.6 Having considered this response, the PRA has decided to maintain the MELL as proposed in CP4/21. The PRA considers that given the forecasted increase in claims and failures as a result of the Covid-19 pandemic, the increases on the MELL are necessary to ensure the FSCS is adequately funded.

Unlevied reserve

2.7 The PRA and FCA consulted on a different approach to the use of the unlevied reserve this year. Under the approach proposed in CP4/21, the unlevied reserve will be used to cover management expenses in relation to both a portion of forecasted claims and unexpected increases in claims, as a result of the difficulty in accurately predicting claims volumes due to the uncertainty of the current economic climate.

2.8 The same two respondents that acknowledged the arguments for the MELL increases also commented on the different approach to the use of the unlevied reserve this year. Both also acknowledged the rationale for the approach.

2.9 One of these respondents supported the approach being taken given the Covid-19 pandemic, however the respondent indicated that they would not support the continuation of the approach

4 Sections 138J(3) and 138J(4) of FSMA.

past the coming year as they believe the approach would reduce the FSCS's capacity to handle additional unexpected claims.

2.10 The other respondent commented that as a degree of uncertainty remains even with expected increases in failures and the reserve remains unlevied, firms will still likely be requested to make additional contributions.

2.11 To give feedback to the concern that the different approach to the unlevied reserve may reduce the FSCS's capacity to handle additional unexpected claims, the PRA clarifies that this is not the case. As in previous years, the unlevied reserve will continue to enable the FSCS to cover unexpected claims that arise throughout the year. The FSCS's capacity to cover any additional unexpected claims has increased compared to previous years given the increase in the unlevied reserve.

Staff headcount

2.12 The FSCS proposed staff costs of £23.4 million, an increase of £0.7 million on the 2020/21 FSCS MELL. These costs include an increase in staff headcount of 13 full-time equivalents and provide a budget of up to 1% for salary increases and 0.5% for hotspots and challenges. The additional headcount will be split across the FSCS' Human Resources, Legal and Operations functions.

2.13 One respondent questioned why rising budget costs for an increase in staff headcount would be necessary given that the FSCS has been outsourcing to manage claims volumes in recent years.

2.14 Having considered this response, the PRA has decided to maintain the MELL as proposed in CP4/21. As noted in the consultation, the additional headcount is necessary for the FSCS to be able to support the expected increases in complex claims and any additional work which goes beyond direct claims handling.

FCA-related and other issues

2.15 Four respondents commented on issues including the increasing and unpredictable interim levies; disparities in the increase in costs between FCA funding classes; and suggestions for a fairer calculation of levies.

2.16 The FCA intends to provide further detail in response to these comments in its Handbook Notice.

Appendix

1 **PRA RULEBOOK: NON AUTHORISED PERSONS: FSCS MANAGEMENT EXPENSES LEVY LIMIT AND BASE COSTS INSTRUMENT 2021, available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/march/ps521app1.pdf.**