

Statement of Policy 3/16

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

June 2023

(Updating March 2019)



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PRUDENTIAL REGULATION  
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## Contents

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<b>1</b>	<b>Introduction</b>	<b>1</b>
<b>2</b>	<b>The risk-based levy calculation formula</b>	<b>1</b>
<b>3</b>	<b>Calculating the aggregate risk score</b>	<b>2</b>
<b>4</b>	<b>Calculating the risk-based levy</b>	<b>6</b>
<b>Appendix - Statement of Policy Update</b>		<b>7</b>

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## 1 Introduction

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

1.2 This methodology will apply only to the calculation of compensation cost 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 PRA SoP, 'Deposit Guarantee Scheme',<sup>2</sup> which applies to the FSCS.

## 2 The risk-based levy calculation formula

2.1 As described in Depositor Protection 42.3, the FSCS is required to calculate firm levies using the following formula (equation 1):

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

2.2 The risk-adjustment factor is composed of the member's aggregate risk weight (ARW), multiplied by an adjustment factor ( $\mu$ ). The ARW for each member will be determined by the PRA (see Chapter 3) and provided to the FSCS. The FSCS will compute  $\mu$ , 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 (equation 2):

$$ARW_i = 75\% + 75\% * (1 - \log_{10} (10 - 9 * (\frac{ARS_i}{100})))$$

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;  
www.legislation.gov.uk/uksi/2015/486/pdfs/ukxi\_20150486\_en.pdf.

2 Updated July 2015, www.bankofengland.co.uk/pr/Pages/publications/sop/2015/fscsdgsupdate.aspx.

### 3 Calculating the aggregate risk score

3.1 For a DGS member that is a CRR firm,<sup>1</sup> 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%
<b>Total</b>	<b>100%</b>

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.<sup>2</sup> 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

<b>Bucket</b>	≤3.25%	>3.25%
<b>IRS</b>	100	0

The leverage ratio will be calculated as defined in the PRA Rulebook.

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

<b>Bucket</b>	≤7%	>7%
<b>IRS</b>	100	0

<sup>1</sup> A UK bank, a building society or a UK designated investment firm.

<sup>2</sup> The Capital Requirements Regulation (575/2013).

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

(iii) Liquidity coverage ratio (LCR)

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

<b>Bucket</b>	≤90%	>90%
<b>IRS</b>	100	0

For all subsequent levies:

<b>Bucket</b>	≤100%	>100%
<b>IRS</b>	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

<b>Bucket (by percentile rank)</b>	0 – 20 <sup>th</sup>	20 <sup>th</sup> – 40 <sup>th</sup>	40 <sup>th</sup> – 60 <sup>th</sup>	60 <sup>th</sup> – 80 <sup>th</sup>	80 <sup>th</sup> – 100 <sup>th</sup>
<b>IRS</b>	0	25	50	75	100

NPL ratio will be calculated as the ratio of non-performing loans<sup>2</sup> to total loans.<sup>3</sup>

DGS members will be ranked and rated separately based on whether they report FSA015, FINREP F18.00 or only FINREP F1.00 and F7.00 returns.

(v) Risk-weighted assets (RWA)<sup>4</sup>/total assets<sup>5</sup>

<b>Bucket (by percentile rank)</b>	0 – 20 <sup>th</sup>	20 <sup>th</sup> – 40 <sup>th</sup>	40 <sup>th</sup> – 60 <sup>th</sup>	60 <sup>th</sup> – 80 <sup>th</sup>	80 <sup>th</sup> – 100 <sup>th</sup>
<b>IRS</b>	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)

<b>Bucket (by percentile rank)</b>	0 – 20 <sup>th</sup>	20 <sup>th</sup> – 40 <sup>th</sup>	40 <sup>th</sup> – 60 <sup>th</sup>	60 <sup>th</sup> – 80 <sup>th</sup>	80 <sup>th</sup> – 100 <sup>th</sup>
<b>IRS</b>	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; or row 330, column 060 of F18.00 (FINREP); or row 0190 column 060, row 0190 column 070, row 0190 column 080 and row 0190 column 090 of F7.00 (FINREP).

3 Defined as field 32H as firms are required to report in form FSA015; or row 330, column 01, of F18.00 (FINREP); or the sum of rows 090, 099, 0130, 0144, 0183 as firms are required to report in form F01.01 (FINREP).

4 Defined as in (1) above.

5 Defined as row 380, column 01 of F01.01 (FINREP).

RoA will be calculated as the ratio of net income<sup>1</sup> to total assets,<sup>2</sup> 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

<b>Bucket</b>	≤1	1 – 2	>2
<b>IRS</b>	100	50	0

This indicator is defined as the ratio of total assets less encumbered assets<sup>3</sup> to covered deposits.<sup>4</sup>

### 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:

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

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)<sup>5</sup> 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:

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1 Defined as row 355, column 01 of F02.00 (FINREP).  
2 Defined as row 380, column 01 of F01.01 (FINREP).  
3 As defined in the EBA guidelines on disclosure of encumbered and unencumbered assets; [www.eba.europa.eu/documents/10180/741903/EBA-GL-2014-03+Guidelines+on+the+disclosure+of+asset+encumbrance.pdf/c65a7f66-9fa5-435b-b843-3476a8b58d66](http://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.  
5 Available at [www.bankofengland.co.uk/pr/Pages/regulatorydata/formscreditunions.aspx](http://www.bankofengland.co.uk/pr/Pages/regulatorydata/formscreditunions.aspx).

## (i) Leverage ratio

Bucket		
Total assets of less than £5 million or fewer than 5,000 members	≤3%	>3%
Total assets of more than £5 million or more than 5,000 members	≤5%	>5%
Total assets of more than £10 million, more than 15,000 members or undertakes an additional activity other than providing transactional accounts	≤8%	>8%
<b>IRS</b>	100	0

Leverage ratio will be calculated as the ratio of total reserves<sup>1</sup> to total assets.<sup>2</sup>

## (ii) Liquidity ratio

Bucket	≤10%	>10%
<b>IRS</b>	100	0

Liquidity ratio will be calculated as the ratio of liquid assets<sup>3</sup> to total relevant liabilities.<sup>4</sup>

## (iii) Non-performing loans (NPL) Ratio

Bucket (by percentile rank)	0 – 20 <sup>th</sup>	20 <sup>th</sup> – 40 <sup>th</sup>	40 <sup>th</sup> – 60 <sup>th</sup>	60 <sup>th</sup> – 80 <sup>th</sup>	80 <sup>th</sup> – 100 <sup>th</sup>
<b>IRS</b>	0	25	50	75	100

NPL ratio will be calculated as the ratio of total net liabilities in arrears<sup>5</sup> to total net liabilities.<sup>6</sup>

## (iv) Return on assets (RoA)

Bucket (by percentile rank)	0 – 20 <sup>th</sup>	20 <sup>th</sup> – 40 <sup>th</sup>	40 <sup>th</sup> – 60 <sup>th</sup>	60 <sup>th</sup> – 80 <sup>th</sup>	80 <sup>th</sup> – 100 <sup>th</sup>
<b>IRS</b>	100	75	50	25	0

RoA will be calculated as the ratio of profit/loss after tax excluding grant income<sup>7</sup> to total assets.<sup>8</sup>

**Overseas firms**

3.9 For a DGS member which is an overseas 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

1 Defined as the sum of fields F1, F2, F7 and F8 in Form CY.

2 Defined as field C16 in Form CY.

3 Defined as field P1 in Form CY.

4 Defined as field P5 in Form CY.

5 Defined as the sum of fields H4, H6, H8 and H10 in Form CY.

6 Defined as field H2 in Form CY.

7 Defined as field L3 less field J6 in Form CY.

8 Defined as in (2) above.

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 paragraph 2.3. The PRA will provide this data to the FSCS.

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

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

4.3 Were there to be no further adjustment, the total industry levy would exceed the levy target. The adjustment factor  $\mu$  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  $\mu$ , 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 42.3 (for compensation cost levies).

## Appendix - Statement of Policy Update

This appendix details changes made to this statement of policy following its initial publication in September 2016, in Policy Statement 25/16 'Implementing risk-based levies for the Financial Services Compensation Scheme deposits class'.<sup>1</sup>

### February 2017

The PRA has updated footnotes in paragraph 3.8 to align with the data item references used in the amended Credit Unions quarterly return (CQ) and annual return (CY) templates published in Policy Statement 31/16 'Credit union regulatory reporting',<sup>2</sup> as follows:

Indicator	Component	Previous reporting field	Revised reporting field
Leverage ratio	Total reserves	2N+2P+42C+42D	F1+F2+F7+F8
Leverage ratio	Total assets	1P	C16
Liquidity ratio	Liquid assets	29E	P1
Liquidity ratio	Total relevant liabilities	30D	P5
Non-performing loan ratio	Total net liabilities in arrears	15CL	H4+H6+H8+H10
Non-performing loan ratio	Total net liabilities	14H	H2
Return on assets	Profit or loss after tax excluding grant income	7-3H	L3-J6
Return on assets	Total assets	1P	C16

### March 2019

The PRA has updated footnotes in paragraph 3.4 to account for the discontinuation of reporting templates FSA001, FSA002 and changes to FSA015, published in Policy Statement (PS) 6/19 'Feedback to responses to Chapters 3-7 of CP24/18'<sup>3</sup> as follows:

Indicator	Component	Previous reporting field	Revised reporting fields
Leverage Ratio	Ratio of Tier 1 Capital to total assets	20A + 20B	Row 340, column 01 of C47.00 (COREP)
NPL ratio	Non-performing loans <sup>4</sup>	11G + 11Q + 20B + 20D + 23B + 23D + 26B + 26D + 31B + 31C	Row 330, column 060 of F18.00 (FINREP)
NPL ratio	Total loans <sup>5</sup>	32H	Row 330, column 010 of F18.00 (FINREP)
RWA/TA	Total assets	20A + 20B	Row 380, column 01 of F01.01 (FINREP)

<sup>1</sup> [www.bankofengland.co.uk/pru/Pages/publications/ps/2016/ps2516.aspx](http://www.bankofengland.co.uk/pru/Pages/publications/ps/2016/ps2516.aspx).

<sup>2</sup> November 2016: [www.bankofengland.co.uk/pru/Pages/publications/ps/2016/ps3116.aspx](http://www.bankofengland.co.uk/pru/Pages/publications/ps/2016/ps3116.aspx).

<sup>3</sup> <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/occasional-consultation-paper>

<sup>4</sup> The previous reporting fields will continue to be used by those firms which do not report FINREP F18.

<sup>5</sup> The previous reporting fields will continue to be used by those firms which do not report FINREP F18.

RoA	Net income	$(2B + 7B + 23B) - (26B + 32B + 33B + 38B + 39B)$	Row 355, column 01 of F02.00 (FINREP)
RoA	Total assets	$20A + 20B$	Row 380, column 01 of F01.01 (FINREP)

### June 2023

The SoP was updated following the publication of PS7/23 – Depositor Protection.<sup>6</sup>

Changes to the SoP consulted upon as part of CP9/22:

- Chapter 1 – paragraph 1.3 was amended to remove the reference to the European Banking Authority Guidelines and the associated footnote was deleted.
- Chapter 3 – paragraph 3.4(i) was amended to change the threshold for the leverage ratio from 3% to 3.25%, it was also changed to explain that the leverage ratio will be calculated as set out in the PRA Rulebook and to delete footnote 3. Paragraph 3.4(iv) was amended to explain that firms will be ranked and rated separately based on which return they report and update footnote 2 and 3 to refer to the relevant sections of F7.00 and F01.01. Paragraph 3.9 was amended to remove references to non-EEA branches.

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<sup>6</sup> Available at: [www.bankofengland.co.uk/prudential-regulation/publication/2023/june/depositor-protection](https://www.bankofengland.co.uk/prudential-regulation/publication/2023/june/depositor-protection).