FSCS, changes afoot

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It was reported last week that the FCA has confirmed that providers will be required to contribute 25% of the bills of the financial advisers’ Financial Services Compensation Scheme (“FSCS”).

What is the FSCS?

The FSCS is designed to provide protection to consumers, by offering a compensation fund to consumers who have suffered harm when an authorised firm has gone out of business. The FCA requires the following to contribute to the FSCS fund:

- Firms who provide or intermediate (i) investments (ii) general insurance (iii) life insurance and (iv) home finance;
- Some debt management/consumer credit firms; and
- Firms that accept deposits.

Background

In 2017, the FCA published a number of discussion and consultation proposals. The aim was to “reduce the volatility of FSCS levies and to assist in ensuring that we have a robust funding model with sustainable classes that provide sufficient funding for compensation”. This included the proposal to require providers to contribute 25% of the funding requirement for the insurance and investment intermediation funding classes.

In addition, the FCA outlined proposals to:

- (a) merge the Life and Pensions Intermediation funding class with the Investment Intermediation funding class and (b) move pure protection intermediation from the Life and Pensions Intermediation funding class to the General Insurance Distribution funding class; and
- Increase the FSCS compensation limit from £50,000 to £85,000 in respect of investment provision, investment intermediation, home finance and debt management claims.

Merging Classes

The purpose of merging the funding classes referred to in (a) and (b) above is with the aim of reducing volatility in FSCS levies and most respondents to the FCA consultation agreed that it would have this effect. In any event, there “is a high degree of commonality between firms in these classes”. As such, the FCA has confirmed its decision to proceed with this proposal. By merging two smaller classes into one large class, the volatility of the levy bill will decrease as it will be split across a wider range of firms, which on the face of it, certainly seems to be good news for the affected firms.

Funding

In respect of the FSCS levy, the FCA consultation asked the question: “Do you agree with our proposal to change the class thresholds for FCA product provider classes to represent 25% of the relevant intermediary claims funding class threshold?”

The FCA received 175 responses to this – some seeking a 50:50 split and some seeking the provider contribution to be set at 75%. The respondents raised the point that whilst intermediaries charge fees for the advice they
give, it is the providers of underlying products who ultimately receive a consumer’s money and therefore the
benefit of that advice.

The FCA set out that its position was based upon the fact that providers benefit from “overall confidence in the
UK market and the structures that exist for the distribution of products to consumers” – therefore, it is fair that
providers play a bigger role in contributing towards the FSCS. In addition, if providers are required to contribute
to the FSCS, this gives them an incentive to design products which benefit consumers and are understood by
intermediaries. As such, it was right that providers should contribute towards the risk of intermediary failure.

The FCA concluded that a 25% contribution from providers would reasonably reflect the policy aims of the FCA
(which includes the aim to reduce volatility) and as such, it has been announced that this levy will be
implemented.

**Increase in compensation limit**

In addition, the FCA has confirmed that increasing the levy to £85,000 will offer a balance between consumer
protection (by reducing the number of “less-than-fully-compensated claimants”) and cost to industry. The new
limit will apply to claims in relation to defaults which occur on or after 1 April 2019. Clearly, increasing the limit
suggests that the FSCS levy will increase, however, the FCA has undertaken a careful analysis of the FSCS
compensation awarded from 2010 – 2017 and has determined that the new limit is appropriate and does offer the
required balance.

**Comment**

Clearly changes are afoot with the way that the FSCS operates. However, those changes are being implemented
after a full FCA consultation and are designed to reduce volatility to the levy and to offer consumer protection.
In addition, the 25% contribution from providers does seem fair, in light of the fact that providers do benefit from
confidence in the market and it is also in their interests to prevent intermediary failure.

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