

Financial Services and Markets

FSCS £326 million interim levy: will you have to pay?

On Thursday 20 January the Financial Services Compensation Scheme ("FSCS") announced that it is imposing an interim levy of £326 million on firms carrying on investment business. This levy will pay for claims paid to customers of intermediary firms which have defaulted over the last year or so, including Keydata Investment Services Limited. Firms will be invoiced by the end of February. This interim levy will hit participant investment managers particularly hard. This note will help you determine whether your firm is required to pay the levy and, if so, roughly how much it is likely to be charged.

What is the interim levy for?

The Financial Services Compensation Scheme ("FSCS") pays compensation to customers of FSA regulated firms which are unable or likely to be unable to pay claims, e.g. due to insolvency. The FSCS is funded through levies on FSA regulated firms which carry on business with or for the benefit of **eligible claimants**. These are customers who could claim against the FSCS if the firm fails. This includes individuals but excludes (for instance) other FSA regulated firms. In addition to the annual levy charged in June/July, the FSCS can raise interim levies to cover projected increased costs. The levy of £326 million is to cover compensation payments which FSCS expects to make in the scheme year 1 April 2010 to 31 March 2011. Keydata Investment Services accounts for a large proportion of this and is the biggest investment failure the FSCS has dealt with.

Will I be affected?

The interim levy will be raised from all firms in the "investment" class of the FSCS. These are firms which carried out designated investment business from 1 April 2010 to 31 March 2011. The only firms which will escape the levy are those which (i) have *already* opted out of FSCS or (ii) have reported to the FSA **annual eligible income** of zero for purposes of their FSCS levy.

How will the interim levy be allocated across firms?

The investment class is split into two sub-classes: investment fund management sub-class (SD01) and the investment intermediation sub-class (SD02). Firms can fall within one or both classes. The compensation due to be paid out by the FSCS mainly relates to failed firms falling within SD02, so the starting point is to levy firms in SD02. However, the compensation will exceed the threshold of amounts which can be levied on SD02 so the investment fund management sub-class will also be levied.

The FSCS has indicated that the interim levy of £326 million will be allocated as follows:

- The SD02 Investment Intermediation sub-class will pay a total of **£93 million**, broken down as follows:
 - **£7 million** will be payable by way of a management expenses levy;
 - **£86 million** will be payable by way of a compensation expenses levy. This is the maximum amount which the FSA can levy on the SD02 Investment Intermediation sub-class in this financial year. £14 million in compensation costs have already been levied in this financial year on the SD02 class, which has an upper limit of £100 million;
- the remaining **£233 million** in compensation costs will be allocated to and imposed on the SD01 Investment Fund Management sub-class.

How much will my firm pay?

The FSA says on its recently updated "fee calculator" page that you can work out an estimate of the share of the levy that your firm may have to pay by using the following formulae:

Investment Intermediation sub-class (SD02):

Share of levy = (£93 million¹ ÷ £3,701 million²) x your firm's annual eligible income for SD02³. **This is equivalent to 2.5% of a firm's annual eligible income.**

Investment Fund Management sub-class (SD01):

Share of levy = (£233 million⁴ ÷ £6,065 million⁵) x your firm's annual eligible income for SD01⁶. **This is equivalent to 3.8% of a firm's annual eligible income.**

¹ The total interim levy to be raised for SD02.

² The total annual eligible income for all participant firms in SD02 according to FSA sources

³ As shown on your 2010/11 regulatory fees and levies invoice for this sub-class

⁴ The total interim levy to be raised for SD01 according to FSA sources

⁵ The total annual eligible income for all participant firms in SD01 according to FSA sources

⁶ As shown on your 2010/11 regulatory fees and levies invoice for this sub-class

The FSA's "fee calculator" page, which has been updated to take account of the latest FSCS interim levy, is at: <http://www.fsa.gov.uk/pages/Doing/Regulated/Fees/calculator/index.shtml>

When will the interim levy be payable?

We understand that relevant participant firms will be receiving invoices soon (we understand that some firms have already received invoices). If a firm chooses to pay its share of the interim levy in a lump sum, it is due and payable within 30 days of the date of the invoice (FEES 6.7.3R). If a firm has previously agreed with the FSCS to pay levies on a quarterly basis by direct debit, then the amount payable under that arrangement will be adjusted to take account of the interim levy quarterly, at the beginning of each quarter, by a direct debit arrangement. (FEES 6.7.1R(2) and 6.7.2G).

The FSCS' Plan and Budget for 2011/12, setting out the anticipated levies for the financial year from 1 April 2011 to 31 March 2012 is also due to be published next month.

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