Bank of England PRA

FINANCIAL CONDUCT AUTHORITY

Consultation Paper

FCA CP25/1** PRA CP1/25

Financial Services Compensation Scheme – Management Expenses Levy Limit 2025/26

January 2025

How to respond

We are asking for comments on this Consultation Paper (CP) by **7 February 2025**.

You can send them to us using the form on our website.

Or in writing to:

Prudential & Redress Policy
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

Email:
cp25-1@fca.org.uk.

Disclaimer

When we make rules, we are required to publish:

- a list of the names of respondents who made representations where those respondents consented to the publication of their names,
- an account of the representations we receive, and
- an account of how we have responded to the representations.

In your response, please indicate:

- if you consent to the publication of your name. If you are replying from an organisation, we will assume that the respondent is the organisation and will publish that name, unless you indicate that you are responding in an individual capacity (in which case, we will publish your name),
- if you wish your response to be treated as confidential. We will have regard to this indication, but may not be able to maintain confidentiality where we are subject to a legal duty to publish or disclose the information in question.

We may be required to publish or disclose information, including confidential information, such as your name and the contents of your response if required to do so by law, for example under the Freedom of Information Act 2000, or in the discharge of our functions. Please note that we will not regard a standard confidentiality statement in an email message as a request for non-disclosure.

Irrespective of whether you indicate that your response should be treated as confidential, we are obliged to publish an account of all the representations we receive when we make the rules.

Further information about the FCA's use of personal data can be found on the FCA website at: www.fca.org.uk/privacy.

Contents

Chapter 1

Summary

Why we are consulting and the wider context

1.1 In this Consultation Paper (CP), we – the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) – set out proposals for the Management Expenses Levy Limit (MELL) for the Financial Services Compensation Scheme (FSCS) for 2025/26. The MELL covers the FSCS's costs of operating the UK's statutory compensation scheme. This CP is supported by the FSCS January 2025 Budget Update published alongside this CP.

1.2 The FSCS is a fund of last resort to provide timely compensation for consumers when financial services firms fail. Its other functions include:

- making recoveries from failed financial institutions
- promoting consumer awareness of FSCS protection
- verifying account information that firms provide to enable faster pay-out to depositors

1.3 Under sections 213(1), 213(3)(b), 213(5) and 223(1) of the Financial Services and Markets Act 2000 (FSMA), the FCA and the PRA are required to set a limit for the total management expenses that the FSCS can levy on financial services firms. The MELL is the maximum amount the FSCS may levy in a financial year for its operating costs, following consultation, without further rulemaking by the FCA and the PRA. Setting the right MELL makes sure the scheme has sufficient funding to exercise the functions conferred on the FSCS by Part XV of FSMA and by rules made by the FCA and the PRA.

Who this CP applies to

1.4 This CP is relevant to all FCA and PRA authorised firms, who fund the FSCS through levies. It contains no material of direct relevance to retail financial services consumers or consumer groups and they do not need to act on it.

1.5 As costs to authorised firms may be passed on to consumers in the form of higher prices, consumers may indirectly contribute to part of the FSCS's levies. However, an efficient and adequately funded compensation scheme benefits all consumers. It helps secure an appropriate degree of protection for consumers of financial services firms and promotes the stability of, and confidence in, the UK financial system.

Summary of the proposal

1.6 The proposed MELL for 2025/26 is £108.6m, made up of:

- the FSCS management expenses budget of £103.6m
- an unlevied reserve of £5m

1.7 The proposed MELL is £0.5m higher in nominal terms than the 2024/25 MELL of £108.1m. However, the FSCS is absorbing some inflation costs, so the MELL is lower in real terms.

1.8 The MELL will apply from 1 April 2025, the start of the FSCS's financial year, until 31 March 2026.

1.9 More details about the MELL, how it is calculated and an explanation of the FSCS unlevied reserve are in Chapter 2 of this CP and in the FSCS January 2025 Budget Update.

1.10 The FCA is required to consult when changing rules under FSMA section 138I. The PRA also has a statutory duty to consult when changing rules under FSMA section 138J.

1.11 None of the statutory panels were consulted about the proposals in this CP. This is because it is a matter for the FCA's and the PRA's statutory oversight of the FSCS, as explained in paragraph 1.3 above. The FCA and the PRA have not consulted their respective CBA panels for the reasons explained in Annex 2.

1.12 In carrying out their policy making functions, both the FCA and the PRA have had regard to all applicable legal obligations. This includes all matters that have informed the MELL proposals. We explain the ways in which having regard to these matters has affected the proposals in Annex 3.

Equality and diversity considerations

1.13 We have considered the equality and diversity issues that may arise from the proposals in this CP – see also Annex 3.

1.14 Overall, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010. However, we will consider the equality and diversity implications of the proposals if any issues are raised during the consultation process, and we will revisit them when making the final rules.

Structure of this CP

1.15 Chapter 2 contains the proposals for the MELL for 2025/26. The key points to note in the budget are set out, alongside further detail on the proposals and an explanation of the FSCS unlevied reserve. Details about how the budget is allocated between FCA and PRA funding classes are given in Appendix 4.

1.16 We have analysed the costs and benefits of the proposed rules (including the impact on mutual societies) as required under FSMA. This includes the FCA's and the PRA's assessment of the compatibility of the proposed rules with their respective statutory objectives (including the FCA's and the PRA's secondary objectives) and regulatory principles. Both authorities have also assessed whether they have carried out their duty to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out their policies, services and functions. Annex 2 provides the cost-benefit analysis (as required by sections 138I and 138J FSMA). Annex 3 assesses compatibility with statutory objectives, including section 138K regarding mutual societies.

How to respond and next steps

1.17 This consultation closes on **7 February 2025**. Please send any comments on the proposed MELL using the online form on the FCA's website or in writing.

1.18 The FCA is accepting responses on behalf of both the FCA and the PRA. Both authorities will consider the responses received and resolve any issues raised.

1.19 Following this, the FCA will issue a Handbook Notice and the PRA will publish a Policy Statement so that their respective final rules can be in place for the start of the FSCS's financial year on 1 April 2025. These communications will also summarise any consultation feedback.

Chapter 2

Proposals for the MELL 2025/26

2.1 In this chapter, we (the FCA and the PRA) set out the proposals for the FSCS MELL for 2025/26. The MELL covers the costs of operating the compensation scheme, to fulfil the obligations imposed on the FSCS by FSMA and set out in the rules made by the FCA and the PRA. It is the maximum amount the FSCS can levy in a financial year for its operating costs without further consultation and rulemaking by us. For the purposes of the MELL, the relevant rules are:

- in the FCA Handbook, the COMP and FEES 6 section of the Handbook
- in the PRA Rulebook, the Depositor Protection Part, the Policyholder Protection Part, the FSCS Management Expenses Levy Limit and Base Costs Part, and the Management Expenses in Respect of Relevant Schemes Part of the Rulebook

2.2 The MELL is the sum of two components:

- the management expenses budget (which is the forecast cost of operating the compensation scheme over the year)
- an unlevied reserve (contingency reserve)

2.3 The unlevied reserve allows the FSCS to raise additional funds at short notice to meet unforeseen operating costs. The MELL does not include claimants' compensation costs as these depend on the number of claims received and are levied separately and without consultation.

2.4 The actual expenses incurred by the FSCS for the year may differ from its budget as this will be based on the total number and type of claims it actually receives. At the end of the financial year, the FSCS will reconcile the actual expenses for the year against the total amount levied and the allocation across funding classes.

2.5 The FSCS forecasts that the management expenses for the current year, 2024/25, will be £101.4m. This is an underspend relative to their budget of £103.1m. Any difference in actual expenses from the budget will be returned to firms through rebates or will be used to reduce firms' future levies.

2.6 The proposed rules through which the FCA and the PRA set the MELL are in Appendices 1 and 2 respectively. The FCA's Oversight Committee (OSC) and the PRA's Prudential Regulation Committee (PRC) have considered the proposals for the MELL and have given their approval for the proposals to go out to consultation.

Management expenses budget

2.7 The proposed management expenses budget for 2025/26 is £103.6m. The management expenses budget is 0.5% (or £0.5m) higher in nominal terms than the 2024/25 management expenses budget of £103.1m. However, due to the FSCS absorbing approximately £2.7m of inflationary costs (based on a CPIH rate of 3.1%, as of August 2024), it is lower in real terms.

2.8 The management expenses budget covers ongoing operating costs of the FSCS. This includes, for example, IT, staffing, outsourcing, legal and claims handling costs. Appendix 3 provides a breakdown of management expenses by line item. Appendix 4 provides a breakdown of management expenses across FCA and PRA funding classes.

2.9 Appendix 3 shows the main areas in which the proposed budget is higher than in 2024/25. These are staff costs, which are proposed to increase by 5% (or £2.5m), and IT costs, which are proposed to increase by 7% (or £0.5m). The budget includes (in staff costs) £0.5m to cover the 1.2 percentage points rise in employers' National Insurance Contributions (NICs) from 1 April 2025. This follows the UK Government's Budget Statement of 30 October 2024. These increases are counterbalanced by decreases in other areas of expenditure, specifically in professional and legal fees which will decrease by 8% (or £0.8m), and in outsourced claims handling which will decrease by 13% (or £1.8m).

2.10 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. One way it has sought to show this commitment in this budget round is by seeking cost efficiencies where possible. This has allowed it to partially self-fund inflationary increases, such as pay rises, for 2025/26.

Unlevied (contingency) reserve

2.11 The unlevied reserve (otherwise known as the contingency reserve) is an important part of the FSCS approach to management expenses and contingency planning. It makes sure that, in the event of unexpected firm failure or exceptional volatility in claims volumes or types, the FSCS can continue to fulfil its statutory obligations. It provides the FSCS with the budget headroom to raise additional funds at short notice to meet such unexpected, or unplanned for, events.

2.12 The unlevied reserve can be levied without further consultation by the FCA and the PRA. To ensure accountability, the FSCS is expected to notify the FCA and the PRA before reserve funds are accessed. The FSCS would report on how it has used the reserve, if accessed, to ensure transparency for levy payers and stakeholders.

2.13 The proposed unlevied reserve for 2025/26 is £5m. This is the same level as the unlevied reserve for 2024/25 and in line with historic levels.

2.14 The FSCS seeks to set the unlevied reserve at an amount sufficient to cover potential eventualities. This year, the FSCS budget has not provided for potential pension advice claims for TenetConnect Limited and TenetConnect Services Limited (which entered administration on 5 June 2024). As claims validity and timings are currently uncertain, we support this approach, which avoids levying firms unnecessarily. The unlevied reserve acts as an important backstop for these types of potential claims. It gives assurance to the FCA and the PRA that the FSCS will be able to fulfil its statutory obligations.

Compensation costs

2.15 The FSCS compensation costs levy, which covers compensation paid to consumers **is not part of the MELL, so is not part of this consultation**. It is determined separately by the FSCS. It is directly linked to the level of compensation claims received from consumers and agreed for pay-out. More details about the compensation costs levy for 2024/25 and the forecast levy for 2025/26 can be found in the FSCS November 2024 Outlook.

Management expenses budget – further detail

2.16 In this section, the FSCS proposed management expenses budget is broken down by activity and information is given about the main changes from last year's budget. The costs by budget line are summarised in Appendix 3.

2.17 In line with previous years, the FSCS distinguishes within its total management expenses between:

- its controllable costs (costs which are not sensitive to changes in claim volumes)
- its volume and complexity driven costs (costs which are sensitive to changes in claim volumes and type)

2.18 In addition, investment costs (which the FSCS defines as costs it requires to deliver on its statutory obligations, priorities and strategic ambition) are factored into its budget proposal. Detailed figures for each of these cost categories by activity are in Table 1 below.

Key points to highlight

2.19 The FSCS forecasts that its overall controllable costs will increase by 1.8% (or £1m) compared to the 2024/25 budget and its volume and complexity driven costs will reduce by 1.2% (or £0.5m) compared to the 2024/25 budget of £42.7m. Investment costs are forecast to stay nominally flat compared to the 2024/25 budget at £5m.

2.20 For context, the FSCS is moving to a new hybrid operating model. It expects the fully operational model to deliver productivity improvements and cost efficiencies in future years. The model will bring most FSCS claims processing in-house, with a new external outsourcer (PwC) having responsibility for all other claims, from 1 April 2025. The FSCS's view is that having more in-house staff building expertise in, and making decisions on, complex claims will help drive improvements to outcomes. Over time, this approach should mitigate risk, increase efficiency, and reduce reliance on external outsourcing, including through:

- strengthening core processes and systems
- improving service quality
- transforming the FSCS approach to claims handling, leading to the delivery of more efficient claims processing

2.21 The expected savings from the shift in the FSCS operating model have begun to materialise. The FSCS anticipates achieving some early productivity savings in 2024/25, with additional cost savings targeted in the future. We will continue to monitor the FSCS's progress towards achieving productivity improvements, especially with more complex claims to be handled in-house. We expect these improvements will lead in time to requests for lower operating costs (on a like-for-like basis) in future budgets.

2.22 Staff costs and outsourced claims handling: controllable staff costs are budgeted to increase by 6% (£1.5m) in 2025/26 compared with 2024/25, and volume and complexity driven contractor costs are also budgeted to increase by 11% (£1.5m) in 2025/26 compared to 2024/25:

- in the case of controllable staff costs, this represents a shift towards in-house staffing (an increased headcount of 10 FTEs). This will reduce reliance on contractors and enhance internal capabilities to support the system used by the FSCS for its transition to a new insurance platform
- in the case of volume and complexity driven contractor costs, the FSCS has faced some challenges in recruiting permanent staff, alongside increased contractor and outsourcing costs. This has caused the ratio between more expensive contractors and permanent staff to increase. However, the FSCS is working to overcome these challenges and seek to convert more of its contractors into permanent staff who cost less. The FSCS expects that, in the longer term, the shift towards more in-house staff will lead to the delivery of future productivity efficiencies. This is shown by the FSCS seeking less budget for outsourced claims handling in 2025/26 – a decrease of 13% (£1.8m) – as it anticipates outsourced advice claims to fall by 35% despite a forecast increase in total claims volumes

2.23 Pay inflation: For 2025/26, the FSCS has proposed an average salary inflation provision of 3% (as advised by an independent benchmarking consultant). 2% of this is earmarked for general salary inflation, with a 1% pot to be used for areas of greater retention risk and the lower paid.

2.24 General inflation: The FSCS is also seeking to absorb general inflationary increases in controllable costs rather than pass them on. This amounts to £1.1m (rounded), based on CPIH of 3.1% (August 2024). It is also maintaining other cost savings from 2024/25 into 2025/26 of £2.5m.

2.25 IT costs: IT costs consisting of increased costs for the operating environment, service optimisation and inflation clauses in software licences, partly offset by savings from cloud optimisation and other IT costs, are expected to be higher by 7% (£0.5m) in 2025/26 than in 2024/25. This is a modest rise.

2.26 The FSCS investment budget concentrates on key mandatory and essential initiatives that support the delivery of its core statutory functions. This includes laying the foundations for future improvements to advice claims handling, focusing in particular on improving the pension calculation process, and further enhancing depositor and policyholder outcomes. We appreciate these ongoing efforts to prioritise an efficient compensation process and an effective protection framework.

Table 1: Management expenses: Activity-based costing (£m) *

ABC Category	2025/26 Budget				2024/25 Budget				Variance	
	Budget	Controllable Costs	Volume & complexity driven	Investment	Budget	Controllable Costs	Volume & complexity driven	Investment	Total	Total %
Claims handling infrastructure & support	**85.8**	**43.6**	**42.2**	**-**	**85.4**	**42.8**	**42.7**	**-**	**+0.4**	**+0.5%**
Outsourced Claims Handling	11.6	-	11.6	-	13.5	-	13.5	-	-1.8	-13.5%
Internal Claims Processing	32.8	6.9	25.9	-	32.8	7.6	25.2	-	0.0	0%
Core Support: IT, facilities, central services	41.3	36.7	4.6	-	39.2	35.2	4.0	-	+2.1	+5.4%
Funding Readiness	**7.0**	**7.0**	**-**	**-**	**7.0**	**7.0**	**-**	**-**	**0.0**	**0%**
Protection, recoveries, investment & pension deficit	**10.8**	**5.8**	**-**	**5.0**	**10.7**	**5.7**	**-**	**5.0**	**+0.1**	**+0.9%**
Consumer Protection	0.3	0.3	-	-	0.4	0.4	-	-	-0.1	-25%
Depositor Protection	2.9	2.9	-	-	2.9	2.9	-	-	0.0	0%
Recoveries	2.6	2.6	-	-	2.4	2.4	-	-	+0.2	+8.3%
Investment/Change	5.0	-	-	5.0	5.0	-	-	5.0	0.0	0%
Pension Deficit Funding	-	-	-	-	-	-	-	-	-	-
Total management expenses	**103.6**	**56.4**	**42.2**	**5.0**	**103.1**	**55.4**	**42.7**	**5.0**	**+0.5**	**+0.5%**

*There are minor rounding differences in the figures in Table 1.

Budget allocation

2.27 The management expenses budget component of the MELL is allocated across FCA and PRA firms to broadly reflect how the operating costs of the FSCS are spent. This determines the levy each firm pays in relation to the MELL. The split between FCA and PRA regulatory fee blocks is made up of:

- A base costs element, which is related to the general running costs of the FSCS and is not directly dependent on the volume or type of claims received. Base costs are split 50/50 between the FCA and PRA regulatory fee blocks as set out in the FCA and PRA rules, and allocated to individual firms in proportion to their regulatory fees
- A specific costs element, which includes the costs of assessing claims, achieving recoveries, and making payments. Specific costs are allocated to the FCA and PRA regulatory fee blocks based on the cost and volume of claims relating to the FCA and PRA funding classes

2.28 The FSCS proposes base costs of £36.9m and specific costs of £66.7m. Appendix 4 shows a breakdown of the proposed budget by funding class. The FCA funding class allocation is forecast to increase by £0.7m in the 2025/26 budget to £63.2m, and the PRA funding class allocation is forecast to fall by £0.2m to £40.4m. The allocation mechanism for levies considers the volume of regulated business conducted by each firm, making sure that those firms with less regulated business contribute less.

2.29 Further information about the FSCS proposed management expenses budget is in its January 2025 Budget Update published alongside this CP.

How these proposals link to our objectives

2.30 Further information about the MELL proposals and how they link to the FCA's, and the PRA's, statutory objectives is in Annex 3.

Annex 1

Questions in this paper

Question 1: **Do you have any comments on the proposed FSCS MELL for 2025/26?**

Annex 2

Cost benefit analysis

Introduction

1. The FSMA, specifically sections 138I and 138J, requires us (the FCA and the PRA) to publish a cost benefit analysis (CBA) when proposing draft rules, defined as 'an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made'. Before making those rules, we are required to (a) consult each other, and (b) after doing so, publish a draft of the proposed rules in the way that appear to us to be best calculated to bring them to the attention of the public.

2. We consider the incremental change in the MELL for 2025/26. The incremental change is an increase of 0.5% (or £0.5 million) relative to last year and is a fraction of the total costs and benefits of the MELL. This CBA also illustrates the costs and benefits of regulatory action by setting them against a baseline of the MELL not being levied and the FSCS not paying out.

3. Our analysis presents estimates of the significant impacts of our proposal, including monetary values for the impacts where we believe it is reasonably practicable to do so. For other impacts, we provide a qualitative explanation. Our proposals are based on weighing up all the impacts we expect and reaching a judgement about the appropriate level of regulatory intervention.

4. The FCA, in line with its Statement of Policy on Cost Benefit Analyses (July 2024) (paragraph 3.20), has not consulted with its CBA Panel in respect to the rules for setting the MELL.

5. The PRA, in line with its Statement of Policy on the PRA's Approach to Cost Benefit Analysis (December 2024), has not consulted with its CBA Panel as the increase in costs of £0.5m relative to 2024/25 is well below the PRA's materiality threshold that determines which CBAs go to the Panel.

Benefits

6. Setting the FSCS Budget at £103.6m and the MELL at £108.6m ensures that the FSCS can continue to operate and meet its objective of providing a compensation scheme that is efficient, fair, approachable and responsive.

7. If a MELL was not set, the FSCS would not be able to operate and provide direct benefits to consumers through the payment of compensation to eligible claimants in the event of firm failure. While the wider benefits of the FSCS are hard to quantify, the direct benefit to consumers from FSCS compensation is forecast to be £367m in 2025/26 (compared with a forecast for 2024/25 of £372m), the amount to be paid out in compensation based on known

and highly likely claims. The amount is based on an estimate of the number of completed claim decisions, the proportion of claims upheld and the average cost of each claim.

8. The existence of the compensation scheme, where applicable, reduces consumers' financial loss and increases consumer confidence in authorised financial services firms. This is particularly important for depositors, as timely compensation in the event of the failure of a deposit taker helps ensure consumer confidence in the financial system. It is also important given that a proportion of claims are made in relation to pension related failures which can affect consumers' retirement income. These wider benefits of the FSCS to the financial system are hard to quantify but are likely to be material.

9. The FSCS seeks to recover costs from the estates of failed firms or from third parties which are responsible for losses on which it pays out compensation. Compensation pay-outs can be partially offset by any recoveries the FSCS makes, demonstrating the commitment of the FSCS to keeping costs low to the benefit of levy-paying firms and consumers.

Costs

10. The FSCS proposes an increase in the budget of 0.5% (£0.5m), which is a minor nominal increase on the previous year, while lower in real terms. The broader benefit is that the FSCS continues to operate an effective compensation scheme on behalf of consumers and seeks to manage its costs efficiently.

11. The one-off direct cost to firms would be equal to the budget of £103.6m. The budget would be split between the FCA and the PRA funding classes and levied on all authorised firms according to the volume of regulated financial services business they conduct. Appendix 4 provides a summary of how the MELL costs are allocated between the FCA and the PRA classes.

12. Management expenses are charged to firms and may be passed on to consumers in the form of higher prices.

13. The unlevied reserve of £5m, which is only invoiced to industry levy payers if required, would give the FSCS some margin to meet costs that exceed its budgeted expenses and that need to be funded at short notice. The FCA and the PRA recognise that the FSCS needs to be able to respond quickly and efficiently to firm failures. Should the FSCS require funding beyond the limit imposed by the MELL due to exceptional circumstances, the FCA and the PRA would urgently consider the request. The unlevied reserve is unchanged relative to 2024/25.

Summary

14. The FCA and the PRA consider that the benefits of providing the FSCS with the MELL outweigh the costs placed on industry, and in particular the incremental changes, primarily because the provision of compensation in the event of the failure of a financial services firm protects consumers by reducing financial harm, which helps to ensure consumer confidence in the financial system.

Annex 3

Statutory Obligations

1. Under sections 138I and 138J FSMA respectively, the FCA and the PRA are required to carry out and publish a cost benefit analysis (CBA) when proposing draft rules – see Annex 2 above – as well as:

- an explanation of the reasons for believing that making the proposed rule is compatible with the FCA's and the PRA's objectives
- to consider if making the proposed rule is compatible with their duty to have regard to the regulatory principles
- a statement as to whether the impact of the proposals upon mutuals will be significantly different than upon other authorised persons.

2. In addition, the FCA and the PRA have to have regard to the recommendations made by the Treasury under section 1JA FSMA and section 30B of the Bank of England Act 1998 respectively about aspects of the economic policy of His Majesty's Government.

3. The FCA and the PRA are also required by the Equality Act 2010 to have due regard to the need to eliminate discrimination and to promote equality of opportunity in carrying out their policies, services, and functions.

FCA's objectives and regulatory principles: Compatibility statement

4. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is compatible with:

   a. its general duty, under section 1B(1) FSMA to, so far as is reasonably possible, act in a way which is compatible with its strategic objective and which advances one or more of its operational objectives,
   b. the requirement under section 1B(4A) FSMA to, so far as is reasonably possible, act in a way which advances the secondary international competitiveness and growth objective, and
   c. its general duty under section 1B(5)(a) FSMA to have regard to the regulatory principles in section 3B FSMA.

5. This section of Annex 3 sets out the FCA's view of how the proposed rules are compatible with its duty to discharge its general functions (which include rulemaking) in a way which promotes effective competition in the interests of consumers (section 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

6. The FCA considers that the proposals set out in this consultation are compatible with the statutory objectives.

Consumer Protection

7. The proposal is primarily intended to advance the FCA's operational objective of consumer protection (section 1C FSMA). The role of the FSCS is, in general, to provide compensation to consumers of financial products when authorised firms are unable, or likely to be unable, to meet their obligations. A compensation scheme provides a safety net, offering protection to consumers, which in turn leads to greater confidence in their dealings with financial services firms, benefitting all firms and leading to a stronger financial system. If the FSCS was unable to process claims because of financial constraints due to an inappropriate MELL, this would undermine the protection offered to consumers.

Competition

8. The proposal is also considered to be compatible with the FCA's competition objective to promote effective competition in the interests of consumers (section 1E FSMA). Any levy placed on a firm because of this proposal will take into account the firm's size, and as such is not likely to disadvantage specific groups, in particular smaller firms.

International competitiveness and growth

9. The FCA considers that the MELL is compatible with the secondary international competitiveness and growth objective. Setting the MELL will assist the FSCS in the timely payment of compensation in the event of firm failures and meeting its objective of providing a compensation scheme that is efficient, fair, approachable, and responsive. This is likely to help increase consumer confidence in authorised financial services where the FSCS applies, supporting international competitiveness and growth.

Conclusion

10. Subject to this consultation, the FCA considers that the proposed FSCS MELL is appropriate. The limit proposed ensures the FSCS has adequate resources to perform its functions for the coming year. In addition, in setting the MELL for 2025/26, the FCA and the PRA have allowed for sufficient unlevied reserve to prevent disruption to the work of the FSCS if it needs to exceed its operating budget for unexpected reasons.

11. When consulting on new rules, the FCA is also under a duty to discharge its general functions in a way which promotes effective competition in the interests of consumers (section 1B(4) FSMA). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

12. Setting a FSCS MELL has no material significance in relation to minimising the extent to which it is possible for a business carried on by an authorised person or a recognised investment exchange, or in contravention of the general prohibition, to be used for a purpose connected with financial crime.

FCA's 'Have regards' analysis

13. As part of this consultation process, the FCA also has to have regard to the regulatory principles set out in section 3B FSMA. The FCA believes that the proposed MELL is compatible with these regulatory principles. The regulatory principles most relevant to this proposal are:

- the need to use the resources of each regulator in the most efficient and economical way; and
- the principle that a burden or restriction should be proportionate to the benefits.

14. The FSCS is operationally independent of, but accountable to, the FCA. This means that the FCA's resources are not directly involved in carrying out the proposed activities.

15. The FCA rules require the FSCS to have regard to the need to use its resources in the most efficient and economical way when carrying out its functions. Setting the MELL, after public consultation, encourages good internal management and effective operating procedures.

16. The FCA believes that an appropriate balance has been struck between the need to ensure their regulatory objectives are fulfilled and the need to keep regulatory burdens proportionate.

17. The FCA's assessment of the fairness and proportionality of the burden and benefits relating to this proposal can be found in the cost benefit analysis section of this CP – see Annex 2 above.

PRA Objectives Analysis

18. The PRA has two primary objectives: a general objective to promote the safety and soundness of regulated firms, and an insurance specific objective to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders. The PRA also has two secondary objectives:

- A competition objective, which is focused on facilitating effective competition in the markets for services provided by PRA-authorised persons in carrying on regulated activities; and
- The competitiveness and growth objective, which is focused on facilitating, subject to alignment with relevant international standards: (a) the international competitiveness of the economy of the UK (including, in particular, the financial services sector through the contribution of PRA-authorised persons); and (b) its growth in the medium to long term.

19. The PRA considers that the proposed rule on setting the MELL is compatible with its general objective. The continued operation of the FSCS with a MELL set at an appropriate level, assists in minimising the adverse impact of a PRA-authorised firm's failure on consumers and enables the FSCS to fulfil its core functions without placing an excessive burden on firms. This promotes firms' safety and soundness, thereby supporting the stability of the UK financial system and enhancing confidence in it.

20. The PRA considers that the proposed rule to set the MELL is compatible with its insurance specific objective because the continued operation of the FSCS with an adequately set MELL assists in ensuring an appropriate degree of protection for policyholders of a PRA-authorised firm that has failed.

21. The MELL is not expected to have any adverse effect on the PRA's secondary objectives of competition, competitiveness, and growth, as it applies to firms in proportion to their share of FSCS-protected business within their funding class. Any levy on a firm as a result of this proposal will take into account the business volume of the firm levied, as well as the claims received in the relevant classes. As such the MELL is not likely to disadvantage specific groups of firms (in particular smaller firms).

22. The PRA considers the MELL is beneficial for competition as the good functioning of the FSCS helps to facilitate orderly failures within the financial system. Facilitating orderly failures is good for competition because it allows for the orderly exit of firms without causing systemic disruption, maintaining consumer confidence in the market and fostering a competitive environment. The FSCS also imposes levies on firms proportionately, promoting a level playing field. Further, the MELL enables the FSCS to operate efficiently and effectively, ensuring it fulfils its role of enhancing confidence in the financial system. This boosts the UK's appeal to businesses and investors and supports its international competitiveness and growth.

23. The PRA considers that the proposed FSCS MELL is appropriate. The limit proposed ensures that the FSCS has adequate resources to perform its statutory functions for the coming year. In addition, in setting the MELL for 2025/26, the PRA and FCA have ensured that there is an adequate unlevied reserve to prevent any disruption to the work of the FSCS if it needs to exceed its operating budget for unexpected reasons. The PRA believes that an appropriate balance has been struck between the need to ensure their regulatory objectives are fulfilled and the need to keep regulatory burdens proportionate.

PRA 'Have Regards' Analysis

24. In developing these proposals, the PRA has had regard to its framework of regulatory principles as set out in section 3B FSMA. The regulatory principles that the PRA considers are most material to the proposals include:

a. The need to use the resources of each regulator in the most efficient and economical way.

- The FSCS is operationally independent of, but accountable to, the PRA. This means that the PRA's resources are not directly involved in carrying out the proposed activities.
- The PRA rules require the FSCS to use its resources in the most efficient and economical way when carrying out its functions. Setting the MELL, after public

consultation, encourages good internal management and effective operating procedures.

b. The principle that a burden or restriction should be proportionate to the benefits.

- The PRA's assessment of the fairness and proportionality of the burden and benefits relating to this proposal can be found in the cost benefit analysis section of this CP (see Annex 2)

25. The PRA has had regard to other factors as required. Where analysis has not been provided against a 'have regard' for this proposal, it is because the PRA consider that 'have regard' to not be a significant factor for this proposal.

Expected impact on mutual societies

26. The FCA and the PRA are required by section 138K(2) FSMA to state their opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

27. The FCA and the PRA do not expect the proposals in this paper to have a significantly different impact on mutual societies. Management expenses are levied on all authorised firms, including mutual societies, according to the volume of regulated financial services business they conduct. The impact on mutual societies is therefore not considered significantly different to that on other types of firms.

HM Treasury recommendation letter

28. In November 2024, HM Treasury made recommendations to the FCA and to the Prudential Regulation Committee (PRC) about aspects of the Government's economic policy to which the FCA and the PRC should have regard when considering how to advance their objectives and apply the regulatory principles set out in FSMA. The FCA and the PRA consider that the recommendation most relevant to the proposal in this CP is:

- creating a regulatory environment which facilitates growth through supporting competition and innovation.

29. We believe that an adequately funded compensation scheme will enhance consumers' trust in UK regulated firms, supporting the growth and competitiveness of the financial services sector. This aligns with the government's priority to promote the sector's growth and international competitiveness, while also maintaining financial stability and consumer protection. It will help to ensure that the UK remains an attractive domicile for internationally active financial institutions and help London maintain its status as a leading financial centre.

Equality and diversity

30. The FCA and the PRA are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, and foster good relations between people who share a protected characteristic and those who do not.

31. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. In considering the proposals set out in this CP, the FCA and the PRA have had due regard to the equality objectives under section.149 of the Equality Act 2010 – see also paragraphs 1.13-1.14 in Chapter 1. The FCA and the PRA consider that the proposals do not give rise to equality and diversity implications under the Equality Act 2010. However, we would welcome any comments respondents may have on any equality issues they believe arise as a result of these proposals.

Annex 4

Abbreviations used in this paper

Abbreviation	Description
ABC	Activity-based costing
CBA	Cost benefit analysis
COMP	Compensation sourcebook
CP	Consultation Paper
CPIH	Consumer Prices Index including owner occupiers' housing costs
FCA	Financial Conduct Authority
FEES	Fees manual
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
FTE	Full time employee
MELL	Management Expenses Levy Limit
NICs	National Insurance Contributions
OSC	Oversight Committee (of the FCA)
PRA	Prudential Regulation Authority
PRC	Prudential Regulation Committee
PwC	Price Waterhouse Coopers

Appendix 1

FCA Draft Handbook text

FINANCIAL SERVICES COMPENSATION SCHEME (MANAGEMENT EXPENSES LEVY LIMIT 2025/2026) INSTRUMENT 2025

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137T (General supplementary powers);
(2) section 213 (The compensation scheme);
(3) section 214 (General); and
(4) section 223 (Management expenses).

B. The rule-making powers listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. The Fees manual (FEES) is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Financial Services Compensation Scheme (Management Expenses Levy Limit 2025/2026) Instrument 2025.

By order of the Board
[*date*]

Annex

Amendments to the Fees manual (FEES)

In this Annex, underlining indicates new text.

6 Financial Services Compensation Scheme Funding

…

6 Annex 1R Financial Services Compensation Scheme - Management Expenses Levy Limit

This table belongs to FEES 6.4.2R	
Period	Limit on total of all management expenses levies attributable to that period (£)
…	
1 April 2024 to 31 March 2025	£108,111,085
<u>1 April 2025 to 31 March 2026</u>	<u>£108,579,230</u>

Appendix 2

PRA Draft Rulebook text

PRA RULEBOOK: NON-AUTHORISED PERSONS: FSCS MANAGEMENT EXPENSES LEVY LIMIT AND BASE COSTS INSTRUMENT 2025

Powers exercised

A. The Prudential Regulation Authority ("PRA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137T (General supplementary powers);
(2) section 213 (The compensation scheme);
(3) section 214 (General); and
(4) section 223 (Management expenses).

B. The rule-making powers referred to above are specified for the purpose of section 138G(2) (Rule-making instruments) of the Act.

PRA Rulebook: Non-Authorised Persons: FSCS Management Expenses Levy Limit and Base Costs Instrument 2025

C. The PRA makes the rules in the Annex to this instrument.

Commencement

D. This instrument comes into force on 1 April 2025.

Citation

E. This instrument may be cited as the PRA Rulebook: Non-Authorised Persons: FSCS Management Expenses Levy Limit and Base Costs Instrument 2025.

By order of the Prudential Regulation Committee
[DATE]

Annex

Amendments to the FSCS Management Expenses Levy Limit and Base Costs Part

In this Annex new text is underlined and deleted text is struck through.

...

2 LIMIT ON MANAGEMENT EXPENSES LEVIES

…

2.1A The amount which the *FSCS* may recover from the sums levied under the *compensation scheme* as *management expenses* attributable to the period 1 April ~~2024~~2025 to 31 March ~~2025~~2026 may not exceed £~~108,111,085~~108,579,230.

…

Appendix 3

FSCS management expenses line by line (£m)

Management Expenses (by account line) (£m) *	2024/25	2025/26	Change	% Change
Staff Costs (incl. contractors)	**52.7**	**55.2**	**2.5**	**5%**
Staff Costs	38.2	39.6	1.4	4%
Contractors	14.5	15.6	1.1	8%
Communications	**3**	**2.8**	**-0.2**	**-7%**
Professional and Legal Fees	**10**	**9.2**	**-0.8**	**-8%**
Professional Fees	5.4	4.7	-0.7	-13%
Legal Fees	4.6	4.5	-0.1	-2%
Outsourced costs	**13.9**	**12.1**	**-1.8**	**-13%**
Outsourced claims handling	13.4	11.6	-1.8	-13%
Outsourced printing & scanning	0.5	0.5	-	-
Investments	**5**	**5**	**-**	**-**
Pension Deficit funding	**0**	**0**	**-**	**-**
Strategic Change Portfolio	**0**	**0**	**-**	**-**
Bank charges	**7**	**7**	**-**	**-**
Facilities, IT, & Overheads	**12.4**	**12.9**	**0.5**	**4%**
Facilities	2.5	2.6	0.1	4%
IT	7.3	7.8	0.5	7%
Depreciation	1.5	1.5	-	-
Other/Contingency	0.5	0.5	-	-
External providers	0.6	0.5	-0.1	-17%
Interest Income	**-0.9**	**-0.5**	**0.4**	**44%**
Total management expenses	**103.1**	**103.6**	**0.5**	**0.5%**

*Minor rounding differences

Appendix 4

FSCS management expenses by FCA and PRA funding class (£m*)

	2025/26			2024/25			Movement (%)		
	FSCS Total Costs (£m)	PRA Fee Block Allocation (£m)	FCA Fee Block Allocation (£m)	FSCS Total Costs (£m)	PRA Fee Block Allocation (£m)	FCA Fee Block Allocation (£m)	FSCS Total Costs	PRA Fee Block Allocation	FCA Fee Block Allocation
Base Costs Total (Split 50:50)	**36.9**	**18.5**	**18.5**	**37.1**	**18.5**	**18.5**	**0%**	**0%**	**0%**
Specific Costs									
Deposits	14.4	14.4	-	14.8	14.8	-	-3%	-3%	-
General Insurance Provision	7.6	7.6	-	7.3	7.3	-	5%	5%	-
Life & Pension Provision	0.0	0.0	-	0.0	0.0	-	0%	0%	-
General Insurance Distribution	1.2	-	1.2	0.8	-	0.8	43%	-	43%
Life Distribution & Investment Intermediation	35.3	-	35.3	35.6	-	35.6	-1%	-	-1%
Investment Provision	8.0	-	8.0	7.3	-	7.3	9%	-	9%
Home Finance Intermediation	0.3	-	0.3	0.3	-	0.3	3%	-	3%
Debt Management	0.0	-	0.0	0.0	-	0.0	0%	-	0%
Funeral Plans	0.0	-	0.0	0.0	-	0.0	0%	-	0%
Specific Costs Total	**66.7**	**22.0**	**44.7**	**66.1**	**22.1**	**44.0**	**1%**	**0%**	**2%**
Management Expenses Total	**103.6**	**40.4**	**63.2**	**103.1**	**40.6**	**62.5**	**0%**	**0%**	**1%**

* Minor rounding differences.

12 Endeavour Square London E20 1JN
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk

Pub ref: 1-008358