13 February 2013

Nadege Genetay
Head of Department, Conduct, Redress and Standards
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Dear Nadege,

FSCS Funding Review

Thank you for publishing CP13/1. We welcome the FSA's decision to review the funding proposals and consult afresh on the retail pool.

The IMA strongly supports the inclusion of contributions from the other providers. This better fits the statutory expectations and the business realities of a compensation scheme of last resort. The primary obligation to provide compensation is assigned to groups of high affinity which are the classes. The secondary obligation to provide cross-subsidy now better reflects the proper responsibilities of providers.

The IMA believes that there is still an opportunity further to strengthen FSCS funding in a way which is fair and consistent with FSA and FSCS objectives. We believe that there is scope for an increased level of potential contributions by PRA providers.

The current proposal flows from the methodology used of assessing PRA provider contributions on a fee basis whilst FCA classes have been assessed on an affordability basis.

Basing other providers' contributions on the basis of fees but the fund managers on affordability, leaves fund managers liable to contribute to a cross-subsidy almost three times the level applied to life insurance companies for misselling of life insurance products. The IMA suggests that this should be reviewed and that the cap for General Insurance firms cross subsidy into the FCA pool be raised to £52m, for Life Insurance to £105m and that for Banks, it should be raised to £165m.

65 Kingsway London WC2B 6TD
Tel:+44(0)20 7831 0898 Fax:+44(0)20 7831 9975
www.investmentuk.org

First, IMA is not convinced that the fees contribution of FCA regulated providers will be 25%. That is information only FCA knows, but IMA would wish to understand that the 25% is expressed as the share of fees borne by firms in the FSCS (and not 25% of all fees since a large number of firms regulated by FCA are not within FSCS).

Secondly, the fee percentage provides a bias against firms prudentially regulated by FCA. FSA decided not to use prudential status as a factor for defining classes, and while this is not in direct conflict with that, nevertheless it does bias the contributions because one provider class is solely within the FCA.

Thirdly, even on this basis members of the Investment Provision pool still provide more cover than any other provider class, despite recent history of liabilities.

The IMA is pleased that the principle of cross-subsidy between pools has been accepted and recognises the time constraints upon FSA as April approaches; consequently, our principal focus is on another rule that may inadvertently exacerbate the position. This is the proposed Rule 6.5A.2R. As we understand it, the rule might, in some circumstances, allow PRA providers to recover payments previously made to the FSA retail pool. The IMA sees two significant potential disadvantages:

First, other firms, including IMA members, will not know their final exposure as the consequence of a cross-subsidy except at the following year end and conditional upon later claims in the PRA providers classes. Even if the chance is remote, this introduces unnecessarily an uncertainty into financial planning as the FSCS levy year may cross the year ends of firms. This could cause particular difficulty for listed firms. This conditionality has the effect of exposing FCA classes to risks arising from PRA class defaults, which FSA was rightly trying to avoid.

> *<u>Example of the conditionality</u>*
>
> *If a cross-subsidy for the FCA retail pool is called and the share is £50m from Life insurers, they pay that. If later life insurers have to find £670m for their own defaults (in the PRA class), as that would otherwise total an outgoing of £720m, then FSCS have to aim to repay £30m to them – and can do this by re-levying the cross-subsidy and asking managers to bear their proportion of that. So managers will not know the true cost of a cross-subsidy until year end.*
>
> *If the same levies were raised in the other order, no correction to the cross-subsidy is made and life insurers end up paying £720m.*
>
> *But in the latter case, (even if very remote) if later a further cross-subsidy were raised (and even if that might have cost life insurers only £1m had they had no claims that year), then the £30m repayment rule is triggered and this would result is a return of money to the life insurers.*

Secondly, this rule introduces another discretionary power exercisable by FSCS in relation to borrowing, which the IMA thinks this should be avoided where possible as it introduces legal uncertainty and risks of challenge.

The IMA understands and agrees with the FSA's desire to ensure the total claim on a PRA class does not exceed the affordability level. And the IMA believes that it is crucial for firms to know that if they have contributed to a cross-subsidy through P&L that the amount payable is final and that later events will not alter it.

So the IMA proposes that FSA deletes rule 6.5A.2R in its entirety and consequently 6.5A.1(1)(b)R and 6.5A.3G as well.

If the FSA believed that this would lead to affordability issues for the PRA classes, it could have reduced the PRA FSCS funding class limits so deposits would then be at £1.39bn; Life providers at £620m; and general insurers at £565m. The IMA deduces however that FSA does not have affordability concerns as the proposed rules envisage that PRA classes may end up contributing £1.61bn for deposits; £760m for insurers; and £635m for general insurance. This is because 6.5A.2R only engages where the retail pool contribution occurs <u>before</u> the levy on the PRA class and 6.5A.1(b) is a binary test of whether the levy cap has been reached or not (and not whether it would be breached).

The removal of these provisions would provide greater predictability and certainty about cross-subsidy in the FCA retail pool; impacts on the FCA pool from the PRA classes would be immunised; the rules would be simpler; and, a discretion that we believe is unhelpful would be removed from FSCS. It would leave PRA classes no worse off in terms of their maximum exposure risk.

Finally, we welcome the clarification in the made rules that borrowing can avoid a cross-subsidy but if there is a cross-subsidy by levy then borrowing only eases liquidity demands on the cross-subsidising party. We believe that this discretion could offer some real opportunities to increase the fairness of the scheme for those most likely to bear the costs of cross-subsidy (those with the deepest pockets). We note the final paragraph of 6.3.2A G, with its suggestion of a presumptive path. We think in any event the G rule should be expressed in a more open-ended manner so that industry and FSCS has greater flexibility in approaching challenging events.

As ever, the IMA would be happy to assist further with any aspect of your consultation,

Yours sincerely

Guy Sears
Director, Institutional