

04/21

Financial Services Authority

Regulatory fees relating  
to mortgage and  
insurance mediation  
regulation

Feedback on CP04/4 and CP04/9  
& made text

October 2004





# Contents

1	Overview	3
2	Funding arrangements for the Financial Ombudsman Service (FOS)	8
3	Funding arrangements for the Financial Services Compensation Scheme (FSCS)	13
4	Intermediate broker failure and the FSCS	19
5	Periodic and application fees for mortgage firms and insurance mediation firms	21
6	Other fee policy issues affecting authorised firms	26

**Annex 1:** List of non-confidential respondents to CP04/4

**Annex 2:** List of non-confidential respondents to CP04/9

**Appendix 1:** Final rules relating to the FOS and the FSCS

**Appendix 2:** Final rules for FSA periodic and application fees

In this Policy Statement, we report on the main issues arising from Consultation Paper (CP) 04/4 (*Mortgage firms and insurance intermediaries: funding of the Ombudsman and Compensation schemes*) and CP04/9 (*Fees issues arising from the regulation of mortgage business and general insurance broking*). We also publish the final rules.

Please address any comments or enquiries relating to feedback on CP04/4 to:

Policy and Technical Standards (Ref: PS04/21)  
High Street Firms Division  
The Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

Telephone: 0845 605 5525  
Fax: 0845 605 5526  
Email: [fsaenquiries@mgi.fsa.gov.uk](mailto:fsaenquiries@mgi.fsa.gov.uk)

Please address any comments or enquiries relating to feedback on CP04/9 to:

Fees Policy (Ref: PS04/21)  
Contact, Revenue & Information Management  
The Financial Services Authority  
25 The North Colonnade  
Canary Wharf  
London E14 5HS

Telephone: 020 7066 1888  
Fax: 020 7066 9764  
Email: [fsafees@fsa.gov.uk](mailto:fsafees@fsa.gov.uk)

For any general fees queries, please consult our website at: [www.fsa.gov.uk/fees](http://www.fsa.gov.uk/fees) You can also contact our Fees Helpline by email: [fsafees@fsa.gov.uk](mailto:fsafees@fsa.gov.uk) or by telephone on 020 7066 1888.

Copies of this Policy Statement are available to download from our website – [www.fsa.gov.uk](http://www.fsa.gov.uk). Alternatively, paper copies can be obtained by calling the FSA order line: 0845 608 2372.

# 1 Overview

- 1.1 This paper provides feedback on CP04/4 (*Mortgage firms and insurance intermediaries: funding of the Ombudsman and Compensation schemes*) and CP04/9 (*Fees issues arising from the regulation of mortgage business and general insurance broking*). It describes the responses we received to the two consultation papers and explains the rules we have made as a result.

## **CP04/4**

- 1.2 In March 2004, we published Consultation Paper (CP) 04/4. In this, we consulted on the funding of the Financial Ombudsman Service (FOS) and the Financial Services Compensation Scheme (FSCS) by firms carrying on mortgage and insurance mediation<sup>1</sup>. Consultation closed on 2 July 2004. This paper reports on the responses to that consultation and the final rules that we have made in the light of these. These rules are in Appendix 1.
- 1.3 We received 34 responses to CP04/4, with the majority coming from the insurance sector. These provided helpful input when we were finalising the rules. We are very grateful to all who commented on the proposals. We have also benefited from discussions with trade associations, the FOS and the FSCS. In general, the responses welcomed our proposals, seeing them as sensible and proportionate. The two main areas of comment were:
- insurers were concerned about the inclusion of direct insurers in the FSCS insurance mediation contribution group; and
  - the proposed levy cap of £100m for the FSCS insurance mediation sub-scheme was widely considered to be too high.
- 1.4 We have considered the responses carefully and have implemented the proposals in CP04/4, subject to some modifications. The main change

---

1 That is in relation to non-investment insurance contracts.

concerns the levy caps for the FSCS mortgage and insurance mediation sub-schemes, where we have adjusted the cap levels in response to firms' concerns. The levy caps have been set at 0.8% of annual eligible income for both sub-schemes, which are equivalent to around £16.5m for the mortgage mediation sub-scheme and around £80m for the insurance mediation sub-scheme, based upon our current annual income estimates.

- 1.5 Although we have made some changes to our rules, these do not alter either the cost-benefit analysis or the compatibility statement we published in CP04/4. Nor do they fundamentally alter our objectives or approach. So we are not changing our explanation in CP04/4 of how our rules are compatible with our regulatory objectives; how they are the most appropriate way of meeting our regulatory objectives; and how they take into account the principles of good regulation in section 2(3) of the Financial Services and Markets Act (FSMA).
- 1.6 The FOS is not setting a general levy for firms doing mortgage or insurance mediation for the 2004/05 financial year. Instead, these firms will pay a special case fee of £550 per complaint handled by the FOS (although it will deal with the first two complaints for free). For the 2005/06 financial year, we will publish a single consultation in January 2005 on the FOS general levy (together with the FSCS levy and FSA fees). This will set out the proposed general levy rates and the minimum levy for each industry block. The FOS will consult separately on the case fee in its annual 'plan and budget' in January 2005.
- 1.7 The levy arrangements for the FSCS are different. The 2005/06 levies will cover the management expenses and the compensation costs for that year, plus the 'stub' period from the date of authorisation to 31 March 2005. In January 2005, we will consult in our single fees paper on the management expenses levy for the 2005/06 financial year. In that paper we will publish the FSCS's forecast of likely compensation levies expected to be raised from the various sub-schemes for the 2005/06 financial year.

### **CP04/9**

- 1.8 In CP04/9, we made proposals on FSA fees issues affecting firms conducting mortgage lending and administration and mortgage mediation and insurance mediation. For the sake of brevity in this Policy Statement (PS), we will refer to such activities as 'M&GI'. We proposed:
  - periodic fees for the M&GI firms from the date those activities become regulated, or (if later) the date when a firm becomes authorised, until 31 March 2005 (the 'stub' period fees);
  - the tariff base (unit of measure) for each of the three new fee-blocks for mortgage lending and administration; mortgage mediation; and insurance mediation;

- application fees for the newly regulated activities after the dates when we start to regulate them;
  - recovering from Designated Professional Bodies the set-up costs of the Register of exempt professional firms carrying on incidental insurance mediation, when the Insurance Mediation Directive comes into force;
  - replacing the approved persons tariff base with an income measure;
  - discounts for firms in multiple fee-blocks; and
  - a small change to the description of the A.13 fee-block concerning client money held for insurance mediation purposes.
- 1.9 We received 28 responses to CP04/9 and 1,500 replies from investment firms to a survey that we conducted regarding the approved persons tariff base, and we had valuable input from trade associations and professional bodies. We are very grateful to all who commented on the proposals.
- 1.10 We have taken responses to the CP and the survey into account. Some respondents were concerned about us setting ‘stub’ fees for M&GI firms while we are uncertain of numbers. In light of this concern, and based on the volume of M&GI applications to date; the distribution of income data on application forms; and our expectations about further applications for insurance mediation, particularly from smaller organisations, we will now make these rates in January 2005, rather than setting them in October as we originally intended. By then, we will have received more applications (particularly from insurance mediation firms) and therefore more data on numbers and ‘sizes’ of M&GI firms for each of the three new fee-blocks. This will enable us to use this up-to-date information to set more accurate fee rates for the ‘stub’ period. We recognise that firms want to know the costs of regulation before M&GI regulation starts. As we said in paragraphs 2.24 – 2.26 of CP04/9, there is a risk that the finalised ‘stub’ fee rates might raise more or less than the amount we expect to recover. We also explained that the full year’s fee rates in 2005/06 could be substantially different to those for the pro-rated ‘stub’ period. However, the rates we proposed in CP04/9 remain materially correct for firms’ budget and planning purposes. We will still invoice firms from June 2005 onwards for the ‘stub’ fees, together with their 2005/06 periodic fees.
- 1.11 Regarding the move to an income measure for firms in our A.12 fee-block (advisory arrangers, dealers or brokers holding client money) and A.13 fee-block (advisory arrangers, dealers or brokers not holding client money), we carried out fee-modelling based on the survey responses. This indicated that we are unlikely to be able to set appropriate fee rates for all the firm types within the fee-blocks. We also took into account the practical and systems implications for firms reporting income to us for fees purposes. As a result, we

are retaining the approved persons tariff base and will not be adopting an income measure for A.12 and A.13 fees in 2005/06. We will keep this issue under review. In Chapter 6, we explain our feedback to the responses we received on the definition of ‘income’ proposed in CP04/9.

- 1.12 The remainder of the proposals in CP04/9 were generally supported or received no substantial comment. So we have made the rules without changes.
- 1.13 The rules we have made as a result of consultation in CP04/9 do not differ from those we consulted on. So we have not drawn up a revised statement of the compatibility of our rules with our statutory objectives and the compatibility statement in CP04/9 remains applicable. We are not required to carry out a cost benefit analysis, as fees rules are exempt from this under Section 155(9)(d) of the FSMA.

### **Structure of this paper**

- 1.14 This paper is structured as follows:
- **Chapter 2** covers the funding arrangements for the FOS.
  - **Chapter 3** covers the funding arrangements for the FSCS.
  - **Chapter 4** covers the FSCS and client money losses arising from intermediate broker failure.
  - **Chapter 5** discusses the FSA periodic and application fees payable by M&GI firms.
  - **Chapter 6** discusses some of our other proposals in CP04/9, including the replacement of approved persons by income as the tariff base in fee-blocks A.12 and A.13, and a discount for firms falling within more than one fee-block but conducting only small amounts of business in each.
  - **Annex 1** lists the non-confidential responses to CP04/4.
  - **Annex 2** lists the non-confidential responses to CP04/9.
  - **Appendix 1** contains the final rules relating to the FOS and the FSCS.
  - **Appendix 2** contains the final rules for FSA periodic and application fees.

### **Who should read this paper?**

- 1.15 This PS deals mainly with the funding arrangements for the FOS and the FSCS and FSA application and periodic fees for M&GI firms. It therefore has most relevance for these firms.
- 1.16 The feedback on CP04/9 is relevant to all authorised firms – particularly those intending to carry out M&GI activities; those within our fee-blocks A.10 to A.14; and designated professional bodies. It may help readers to refer to the

*'Consolidated policy statement on our fee-raising arrangements'*<sup>2</sup> together with this paper, for a broad overview of our fee-raising arrangements. All FSA publications mentioned in this paper are on our website at: [www.fsa.gov.uk/pubs](http://www.fsa.gov.uk/pubs)

## **CONSUMERS**

Chapter 4 explains the rules we are making that will enhance consumer protection in the eventuality of an intermediate broker failing and causing the loss of client money. However, the rest of this paper contains no material of direct relevance to consumers or consumer groups, although our fees are partly met (indirectly) by consumers of retail financial services.

# 2 Funding arrangements for the Financial Ombudsman Service (FOS)

2.1 In PS186 and PS04/1, we confirmed that we would be extending the compulsory jurisdiction of the FOS to include firms carrying out mortgage lending and administration and mortgage and insurance mediation. In CP04/4, we consulted on the framework for the funding of the FOS by firms doing mortgage and insurance mediation. In general, respondents welcomed our proposals and had no major concerns.

## **Separate funding blocks**

- 2.2 **Background:** The FOS budget is covered by a combination of a general levy on all firms and a case fee charged to firms for individual complaints. The general levy is intended to cover the fixed costs of the FOS (e.g. its administrative overheads and operating costs), while the case fee covers the costs of processing complaints. The general levy is consulted on by the FSA each year.
- 2.3 For the purposes of the general levy, all eligible firms are allocated into fee groups known as 'industry blocks' and these mirror, as far as possible, the FSA fee blocks. Each industry block has its own tariff base, which is used to determine an individual firm's contribution to the general levy. There is a minimum levy for individual firms in each industry block, with no maximum limit. Firms are allocated individual levies on a 'straight line' basis. This means their levy increases uniformly in line with the amount of 'relevant business' transacted by the firm.
- 2.4 The case fee is set separately by the FOS. This is a single flat rate fee charged for the handling of each complaint, and this flat rate applies across all industry blocks. The FOS will not be setting a general levy for firms doing mortgage and insurance mediation for the 2004/05 financial year. Instead, in keeping with its existing policy for firms that do not pay a levy, the FOS has proposed that firms doing mortgage and insurance mediation will be subject to a special case fee of £550 per complaint. However, it will not charge firms a fee for handling their first two complaints each year.

- 2.5 In CP04/4 we proposed establishing two new separate industry blocks for mortgage and insurance mediation. We asked:
- Q1: Do you agree that there should be separate industry blocks for mortgage and general insurance business?
- 2.6 **Consultation response:** On the whole, respondents welcomed the proposal to create separate industry blocks for mortgage and insurance mediation. Respondents felt that this was the most equitable way to distribute costs without cross-subsidisation of activities and was consistent with the approach adopted for other sectors. The main comment came from insurers and mortgage lenders, concerned about their inclusion in the new mediation groups when their contributions to the blocks for insurers and mortgage lenders already take their mediation activities into consideration. These respondents felt it was not fair for them to additionally contribute for activities already covered by the FOS's jurisdiction. Some respondents also asked for clarification on the position of managing agents at Lloyd's.
- 2.7 The Association of Mortgage Intermediaries suggested that firms who carry on both insurance and mortgage mediation should benefit from a 50% discount on the FOS fee for those activities that are secondary in nature.
- 2.8 Clarification was requested on the treatment of appointed representatives and whether the appointed representative or the principal will benefit from the two free cases per year offered by the FOS.
- 2.9 **Our response:** We accept the issue raised by insurers and mortgage lenders about potential 'double charging'. We have agreed with the FOS that it will reduce the contribution of insurers and mortgage lenders in their respective industry blocks. This will reflect the fact that complaints relating to their mediation activities will now be covered by the two new industry blocks. The FOS aims to do this by calculating the cost of dealing with complaints due to mortgage and insurance mediation activities, which currently fall on industry block 1 (Deposit acceptors, mortgage lenders and administrators) and industry block 2 ( Insurers – general). They will then reduce the levies due under these blocks by a corresponding amount. Apart from this minor adjustment, we have proceeded with the proposal for two new industry blocks – one to cover mortgage mediation activities and the other to cover insurance mediation activities.
- 2.10 While only a small minority of managing agents at Lloyd's sell directly to customers, all will have to vary their permission to reflect their role in arranging and dealing in non-investment insurance contracts. This will mean they are included in the FOS industry block for insurance mediation. However, managing agents may be able to report a zero annual income figure for the purpose of their FSA fees if they do not sell directly – they will therefore only be liable for the minimum levy for this industry block.

- 2.11 We have confirmed in paragraph 6.26 of this PS that firms with multiple fee block membership will, from 2005/06, benefit from a 50% discount on FSA fees in any fee block for which it is liable only for the minimum fee. But we do not think it is justified to apply this approach to the FOS general levy, as the sums of money in question are smaller. For example, the minimum FOS levy for the IFA industry block is currently £75.
- 2.12 FSMA enables authorised persons to choose whether to appoint representatives. The FOS recognises this principle by dealing with the principal firm in complaints against its appointed representatives. It is for appointed representatives to weigh up the costs and benefits of a principal bearing responsibility for their regulated activities. On this basis, the principal – and not the appointed representative – is entitled to two free cases a year. If a firm belongs to both the new mediation blocks, their two free case allocation covers *both* blocks i.e. they will not be entitled to two free cases for mortgage mediation activity *and* two free cases for insurance mediation activity. The firm will get two free cases in total.

### Tariff base

- 2.13 **Background:** The tariff base is used to measure the amount of business conducted in an industry block by each firm. This is used to calculate a firm's share of the levy. In CP04/4 we proposed to base the FOS tariff base for mortgage and insurance mediation on the same annual income measure as FSA fees. This is in line with the general principle that FOS tariff bases should follow FSA tariff bases as far as possible. We asked:

Q2: Do you agree with the proposal that the FOS tariff-base should be based upon income?

- 2.14 **Consultation response:** The majority of respondents agreed that the use of annual income was the most equitable and consistent measure for FOS fees. Two respondents suggested using market share or policyholder numbers as alternative measures.

- 2.15 **Our response:** We do not think either of the suggested alternative approaches would be administratively feasible. So we have gone ahead with the annual income measure.

### Tailored income option

- 2.16 **Background:** In CP04/4, we proposed that firms should be given the option to report their annual income from relevant business (i.e. the business firms conduct with private individuals). This is because certain firms' annual income may include only a small proportion relating to business with private individuals. We asked:

Q3: Do you agree that firms should be offered the opportunity to report a tailored annual income (annual income from relevant business) where it is economic for them to do so?

- 2.17 **Consultation response:** Respondents strongly endorsed having the option to report annual income from relevant business. However, several respondents noted the practical difficulties of identifying income from relevant business. One firm pointed out that while identifying annual income from business with retail customers was straightforward, it would be more difficult to establish which of its small business customers would be eligible FOS complainants. A few sought clarification on how accurate the income figure from relevant business should be, and whether reasonable estimates would be acceptable.
- 2.18 **Our response:** For the purpose of FOS fees, income from relevant business is the income generated from firms' business with private individuals only (i.e. it excludes small businesses that can refer a complaint to the FOS). It should be noted that this differs from the approach for FSCS fees (see paragraph 3.15 below). A firm is not required to determine which of its small business customers are eligible complainants. This will ease the reporting procedures for firms.
- 2.19 In the light of responses, we have proceeded with our proposal for firms to have the option to report annual income from relevant business or total annual income for the purpose of calculating their FOS fees. If firms wish to report annual income from relevant business they must submit their statement of annual income from relevant business to us before 28 February 2005 for the purpose of the 2005/06 financial year. Firms should use the tailored income form at: [www.fsa.gov.uk/fees/fee\\_tariff.html](http://www.fsa.gov.uk/fees/fee_tariff.html) for the 2005/06 financial year only. In respect of future years, we will collect this information from their regulatory returns. If firms wish their FOS fees to be calculated on their total annual income, we will use the annual income figure firms reported on their application forms and firms will therefore not have to provide us with additional information for the 2005/06 financial year fees. For each subsequent year, firms will have the option each year to report either their tailored annual income from relevant business or their total annual income for the purpose of FOS fees. If firms decide not to report a tailored annual figure by the required date each year, they cannot subsequently change their annual income in the course of that financial year.
- 2.20 Other firms subject to the FOS have to report their income from relevant business to us each year (i.e. they do not have an option not to). We will keep the option for firms doing mortgage and insurance mediation under review and if we find that the majority of firms are reporting income from relevant business, we may consult on removing the option in the future to bring firms doing mortgage and insurance mediation in line with other firms subject to the FOS.
- 2.21 A number of firms asked us how accurate the figure on annual income from relevant business should be. A firm's management is responsible for its activities and for ensuring compliance with regulatory requirements, including the provision of the accurate and complete information required for calculating FOS levies. We accept that, in some cases, the costs of obtaining precise figures would be disproportionate for firms and so estimates will be necessary. In these cases, the management of firms will be responsible for the appropriateness of any estimates. We would reserve the right to check any figures and assess how reasonable any estimates were.

## **The position of credit unions, cash plan health providers and friendly societies**

- 2.22 Credit unions, cash plan health providers and friendly societies currently pay a fixed flat rate fee of £50 to the FOS and are excluded from other industry blocks. This was consulted on in CP74 and confirmed in the Policy Statement *Dispute Resolution: The Complaints Sourcebook* (Oct 2001). This is to take into account that these firms are essentially ‘not for profit’ organisations.
- 2.23 However, in CP04/4 we omitted to exclude credit unions, cash plan health providers and friendly societies from the mortgage and insurance mediation blocks. This is out of line with established policy and we have amended the final rules accordingly. As is current practice, this arrangement will be kept under review and revised if levies raised do not meet the cost of dealing with complaints relating to these firms.

### **Final rules**

- 2.24 We asked:

Q4: Do you have any comments on the draft rules in Annex 2 as they apply to the FOS?

Respondents provided minor general comments, leading to the following small changes to the rules:

- We have changed the date from which the rules take effect to reflect the start of regulation for mortgage mediation and non-investment insurance mediation respectively.
- We have made changes to the rules to clarify that firms have the option of reporting total annual income *or* annual income from relevant business. Those firms wishing to report annual income from relevant business will need to provide the FSA with this information by the end of February 2005.
- We have provided guidance for firms wishing to report total annual income. For 2005/06 we do not require firms to provide us with this information as we will use information obtained in the authorisation process or from applications for variation of permission.
- With regard to the definition of annual income, we have changed the reference point from ‘*Note 3 to AUTH 4 Ann 2R*’ to ‘*SUP 20 Ann 1R*’, as the latter reference provides the definition used for FSA fees.
- We have excluded credit unions, cash plan health providers and friendly societies that are already in industry blocks 13, 14 and 15 from industry blocks 16 and 17.

# 3 Funding arrangements for the Financial Services Compensation Scheme (FSCS)

## Background

- 3.1 The FSCS compensation payments are made through sub-schemes containing firms carrying out broadly the same activities. CP186 and PS174 announced that we would create two different sub-schemes for mortgage and insurance mediation activities. Firms contribute to the FSCS through their membership of the contribution groups within the FSCS sub-schemes. Firms carrying out more than one regulated activity contribute to the relevant sub-scheme for each activity through the appropriate contribution group. The costs of compensation when a firm defaults fall to the other firms in that contribution group.
- 3.2 The FSCS can make two types of levies on firms – for management expenses and for compensation. The management expenses levy has two components – the base operating costs and the specific costs of processing claims. All firms must pay the base costs, including those firms that are exempt from the FSCS compensation and specific costs levy. Firms pay the base costs component of the levy, based upon their FSA periodic fees. The specific costs and compensation levy is only levied on those contribution groups where claims have been incurred. This levy is based on the tariff base set for the relevant FSCS sub-scheme.

## Separate contribution groups

- 3.3 **Background:** In CP04/4, we proposed setting up a single contribution group in each of the mortgage and insurance mediation sub-schemes. Each group would contain all firms that carry out mediation activities in relation to regulated mortgage contracts or non-investment insurance contracts. We asked:

Q5: Do you have any comments on the proposal to set up contribution groups for mortgage and general insurance business?

3.4 **Consultation response:** In general, respondents agreed with the principle of separate contribution groups for mortgage and insurance mediation activities. They agreed that membership should be based upon activity, rather than firm type. However, the main objections to the proposal came from insurers. They did not consider it appropriate for the insurance mediation contribution group to include direct insurers (i.e. insurers who sell directly to customers) when they are already in the FSCS as members of the general insurers contribution group. These insurers put forward three broad arguments against direct insurers being included in the insurance mediation contribution group:

- they are already members of the insurers' contribution group, and so they should not have to contribute again to the FSCS;
- they considered their mediation activities to be lower risk than those of brokers; and
- they suggested that their prudential regime would mean that their risk of failure was lower than that of brokers, and so they would be subsidising brokers.

3.5 **Our response:** We think direct insurers should be part of the insurance mediation contribution group because:

- the FSCS contribution groups are generally based upon activity and not firm type. Consequently, insurers are not alone in having to contribute to more than one FSCS contribution group. Credit institutions (banks, building societies and credit unions) also fall into the insurance mediation contribution group when they carry out such activities. Like insurers, they are subject to a different prudential regime to brokers.
- We have seen no evidence that sales by direct insurers present a lower risk of negligence or mis-selling than sales through brokers.
- Some insurers operate through an extensive network of appointed representatives (ARs). The principal firm – not its ARs – is a member of the FSCS. There is little difference between the activities of an AR and those of a directly authorised broker. So excluding insurers from the insurance mediation contribution group would result in inconsistent treatment of directly authorised brokers compared with a direct insurer's ARs.

3.6 We have therefore gone ahead with the proposal for a single contribution group in the mortgage mediation sub-scheme and a single contribution group in the insurance mediation sub-scheme. The latter group will include direct insurers.

### **The levy caps**

3.7 **Background:** Each sub-scheme has a levy cap that sets the maximum compensation levy that the FSCS can raise in any one financial year. In

CP04/4, we proposed levy caps of £20 million for the mortgage mediation sub-scheme and £100 million for the insurance mediation sub-scheme. We asked:

Q6: Do you have any comments on the proposed levy caps for the mortgage and general insurance sub-schemes?

3.8 **Consultation response:** This was the most opposed of all the CP04/4 proposals, particularly among smaller insurance brokers. There was a general view that the £100m cap proposed for the insurance mediation sub-scheme was too high. However, only one respondent questioned whether the £20m levy cap for the mortgage mediation sub-scheme might be too high.

3.9 **Our response:** To address the concerns of the insurance sector and other respondents about the level of the levy caps we have made the following changes and commitment about a future review:

- We have changed the levy cap from an absolute cash amount to a percentage limit of a firm's annual eligible income. This will enable firms to work out the maximum levy they could potentially face individually.
- It is very difficult to decide on an appropriate levy cap in the absence of any data on the likely levels of firm failures and relevant consumer losses. The proposed limits of £100m for the insurance mediation sub-scheme and £20m for the mortgage mediation sub-scheme in CP04/4 were based partly upon initial estimates (in early 2004) of the likely annual income of firms in the two contribution groups. At the time, we estimated that the proposed levy caps would be equivalent to 1.5% of annual income for both groups. Application data from firms applying for authorisation or to vary their permission now suggest that the levy we proposed in CP04/4 would have accounted for a lower proportion of annual income than originally estimated – around 1% of annual income based on current applications. Our estimate also assumes that a fair proportion of firms carrying out insurance mediation will choose to report a lower tailored annual income figure that excludes income derived from business with customers who are not eligible to claim on the FSCS. We have adjusted the levy caps to 0.8% of annual eligible income for both sub-schemes. Based on our current annual income estimates, this is equivalent to around £16.5m for the mortgage mediation sub-scheme and £80m for the insurance mediation sub-scheme. We consider the new levy caps reasonable and proportionate. They are in line with the current levy cap for the insurer sub-scheme (0.8% of relevant net premium income).
- If compensation claims turned out to be higher than expected and the contribution group faced a levy close to the levy cap, this would trigger a fundamental review of the financial safeguards in place for mortgage and insurance mediation (i.e. capital & PII requirements and client money rules).

## Tariff base

- 3.10 **Background:** The tariff base is used to measure the amount of business conducted by each member firm in a contribution group. This is used to calculate a firm's share of the compensation levy and the specific costs levy for that contribution group. In CP04/4, we proposed that the tariff base for the mortgage and insurance mediation contribution groups should be based upon annual income, as is the case for FSA fees. This is in line with the general principle that FSCS tariff bases should follow FSA tariff bases as far as possible. We asked:

Q7: Do you agree with the proposals for the FSCS tariff-base?

- 3.11 **Consultation response:** Most firms were content with our proposal to use the same annual income measure as for FSA fees. However, several respondents were concerned that such an approach would mean larger firms were effectively subsidising smaller firms. This would be because larger firms report higher income figures and therefore would be subject to higher levy amounts.

- 3.12 **Our response:** We have implemented our proposal that the FSCS tariff base be based on the annual income tariff base, as used for FSA fees. Our Consolidated Policy Statement<sup>3</sup> on fees explains that generally, the tariff bases for FSCS contribution groups mirror those for the corresponding FSA fee-blocks. We charge FSCS compensation and specific cost levies on a 'straight line' basis, according to each firm's share of the total tariff base for the relevant contribution group. So firms in a particular contribution group pay compensation cost levies in direct proportion to their FSCS tariff data, where defaults are directly attributable to that contribution group. We believe this approach remains fair to all fee-payers within a contribution group.

## Tailored income option

- 3.13 **Background:** In CP04/4, we proposed that firms should have the option to report a tailored figure representing their annual income from eligible claimants only, where it makes economic sense to do so. This would benefit firms with predominately large commercial customers, such as firms active in the London market. It would mean a closer match between the tariff base and the potential compensation impact on the insurance mediation sub-scheme. The option would also benefit those firms with large commercial mortgage business in the mortgage mediation sub-scheme. We asked:

Q8: Do you agree that firms should be offered the opportunity to report a tailored annual income (eligible annual income), where it is economic for them to do so?

- 3.14 **Consultation response:** This proposal was strongly welcomed by firms. However, many noted the potential difficulties in establishing annual income from eligible claimants with reasonable accuracy. One respondent suggested

---

3 PS04/15 'Consolidated policy statement on our fee-raising arrangements' (May 2004)

that firms could report the same tailored income figure for both FSCS and FOS purposes. Several brokers proposed that firms should be allowed to calculate their eligible income on a best endeavours basis, for instance by making a reasonable estimate. One intermediary argued that the FSCS levy should relate only to actual client money held by the broker. They maintained this on the grounds that any losses of premium/claims money from brokers with risk transfer agreements would be covered by their insurers rather than the FSCS.

- 3.15 **Our response:** In the light of this feedback, we are giving firms the option to report a tailored figure for annual income from eligible claimants. If firms wish to take advantage of this option, they will have to report the figure by the end of February 2005. Firms should use the tailored income form at: [www.fsa.gov.uk/fees/fee\\_tariff.html](http://www.fsa.gov.uk/fees/fee_tariff.html) for the 2005/06 financial year only. In respect of future years, we will collect this information from their regulatory returns.
- 3.16 A number of firms asked us how accurate the tailored figure should be. Our position on this is set out in paragraph 2.21. Firms should note that if they take advantage of the tailored income option, the tailored income figures they produce for FOS and FSCS purposes will not be identical. This is because the definition of a FSCS eligible claimant is different from the relevant business that firms may report for FOS (see paragraph 2.18 above).
- 3.17 Once firms have decided whether to report a tailored figure – or rely instead on their annual income figure as reported on their application forms – they cannot subsequently change this figure in respect of that financial year.
- 3.18 We considered the feasibility of reducing the levy contribution for insurance brokers who did not hold client money and whose business was covered by risk transfer agreements. The approach would be fair, as it recognises that customer money held by brokers is protected by the insurers under such agreements. However, risk transfer agreements do not cover losses due to mis-selling or negligence, and these would have to be covered by the FSCS. Furthermore, it would be difficult and administratively complex to determine what the levy reduction should be for such firms. Consequently, we have decided not to pursue this approach.

### **FSCS scope including reinsurance mediation**

- 3.19 Although we made the rules in January 2004 to bring insurance mediation within the scope of the FSCS, some respondents raised concerns about the scope of the FSCS in relation to insurance mediation claims in the context of their responses to CP04/4. These included concerns about the definition of an eligible claimant and about the territorial scope of the FSCS in respect of insurance mediation claims. Specifically, the concern about the definition of an eligible claimant was that fairly sizeable corporate customers would be able to make claims. The concern about territorial scope was that overseas customers and brokers would be able to make claims in respect of business that transacts through a wholesale broker in the London market if that broker becomes insolvent and there is a claim against him. Consultation on CP04/9 also raised

an issue about reinsurance mediation, which we have dealt with below. We are considering the other issues raised concerning the scope of the FSCS and we will aim to take action to amend the rules before regulation of insurance mediation starts on 14 January 2005, if we consider it justified.

- 3.20 We have amended the rules to make it clear that protected insurance mediation claims covered by the FSCS exclude claims related to reinsurance mediation. We have previously excluded reinsurance mediation from the Insurance: Conduct of Business sourcebook rules, as we do not consider that customers of firms conducting reinsurance mediation need the same level of protection as other customers. The amendment we have made in respect of the FSCS is consistent with this. It brings protected insurance mediation claims into line with the FSCS coverage for protected contracts of insurance, which exclude reinsurance contracts. It means that if firms choose to report a tailored annual income figure for the FSCS, they can exclude the income they receive from reinsurance mediation. If they carry out reinsurance mediation only, they may be able to apply for an exemption (this exemption form can be downloaded from our website: [www.fsa.gov.uk/fees/fee\\_tariff.html](http://www.fsa.gov.uk/fees/fee_tariff.html)).
- 3.21 Firms who are exempt will not have to pay the compensation levy and the specific costs levy. However, we will still require them to contribute to the base costs component of the management expenses levy as members of the insurance mediation contribution group. This is because the base costs component is based upon their FSA periodic fees.

### **Final rules**

- 3.22 We asked:

Q9: Do you have any comments on the draft rules in Annex 3 as they apply to the FSCS?

Respondents provided minor general comments or reiterated points made in responses to other aspects of CP04/4. The final rules we have made reflect various drafting changes, which are summarised below:

- We have changed the date from which the rules take effect to reflect the start of regulation for mortgage mediation and insurance mediation respectively.
- With regard to the definition of annual income, we have changed the reference point from 'Note 3 to AUTH 4 Ann 2R' to 'SUP 20 Ann 1R', as the latter reference provides the definition used for FSA fees.
- We have revised the wording of COMP 13.4.7RA and B to reflect the changes to the levy caps for the mortgage mediation and insurance mediation sub-schemes, as described above.
- We have amended COMP 5.6.1R to make it clear that protected non-investment insurance mediation does not include mediation relating to reinsurance contracts.

# 4 Intermediate broker failure and the FSCS

4.1 **Background:** Under the current compensation scheme rules, customers whose client money is held at an intermediate broker would not be able to claim on the FSCS for client money losses arising from the failure of that intermediate broker. We decided that amending the client money rules to impose a fiduciary obligation to the customers of the customer-facing broker on each broker in the chain would be impractical. Instead, in CP04/4 we consulted on draft rules to permit a customer-facing broker to make a claim on the FSCS on behalf of any customers affected by the shortfall in client money caused by the failure of an authorised intermediate broker. This will ensure that a customer can receive compensation from the FSCS whether or not he or she had a direct relationship with the failed broker. We asked:

Q10: Do our proposals for intermediate brokers provide the appropriate level of protection to customers?

4.2 **Consultation response:** Support for this proposal was virtually unanimous. Respondents were pleased that we had recognised this important issue and had offered a well thought-out and proportionate response. Two key issues were raised:

- firstly, whether a customer-facing broker should be obliged to submit a claim to the FSCS as the administration involved could be a disincentive for them to do so; and
- secondly, that intermediate brokers could be exempt from contributing to the FSCS levy.

4.3 **Our response:** We have gone ahead with our proposal to permit, but not oblige, a customer-facing broker to make a claim on the FSCS in the event of the failure of an intermediate broker. We think that a customer-facing broker would have a strong incentive to make good the loss itself or to make a claim on the FSCS to maintain its reputation. If we were to oblige the customer-facing broker to make a claim on the FSCS, this would remove any fiduciary duty that the broker might have to make up the

shortfall itself. Furthermore, if a customer-facing broker did not make up the shortfall or make a claim on the FSCS, we could exert pressure on it to do so, given its duties to customers and its obligations under the Principles for Businesses.

- 4.4 The intermediate broker's customers are the other brokers that he or she is in contact with, rather than the 'end' customers of the customer-facing broker. Some of these other brokers may be eligible claimants, but others may not. As the rules stand the intermediate broker does not have to take account of the identity of the 'end' customers whose client money he holds if he chooses to report a tailored annual income figure. The rules would allow an intermediate broker to apply for exemption from the FSCS levy if none of the brokers he deals with were eligible claimants, regardless of the fact that he could be holding client money of end-customers who were eligible claimants. Potentially, this means that the contribution to the compensation levy to be paid by intermediate brokers will not reflect the potential impact of claims that could be made on the FSCS as a result of their insolvency.
- 4.5 We are considering amending the rules to require intermediate brokers to contribute to the levy in a way that best represents the potential compensation impact they could have on the FSCS.

## Final rules

- 4.6 In CP04/4 we asked:

Q11: Do you have any comments on the draft rules in Annex 4 as they apply to the FSCS and client monies?

Respondents provided minor general comments. The final rules that we have made reflect various drafting changes, which are summarised below:

- We have changed the date from which the rules take effect to reflect the start of regulation for insurance mediation business.
- The draft rules in Annex 4 of CP04/4 would have applied to client money for investment business as well as mediation for non-investment insurance contracts. However, the CP was directed at mortgage firms and firms carrying out insurance mediation in relation to non-investment insurance contracts and made no mention of investment business. We did not receive any responses from firms or trade associations in respect of investment business. Accordingly, we have revised COMP 3.2.4R to make it clear that the amendments for intermediate broker failure apply only to claims in connection with protected non-investment insurance mediation.
- We have made a minor change to COMP 10.2.9R and COMP 12.6.12R. This clarifies that for the purpose of calculating compensation the FSCS must treat each of the 'end' customers as having the claim, rather than the customer-facing firm.

# 5 Periodic and application fees for mortgage firms and insurance mediation firms

5.1 Chapter 2 of CP04/9 explained how we would recover our costs from M&GI firms in 2004/05, and contained proposals on the 2004/05 periodic fee rates (the ‘stub’ fees) for the newly regulated activities from the dates when regulation starts or (if later) the date when a firm becomes authorised, until 31 March 2005. We also set out how we intend to recover costs from Designated Professional Bodies (DPBs) for setting up the Register of exempt professional firms carrying on incidental insurance mediation. In addition, we proposed a new basis for application fees for M&GI firms once those activities become regulated. In this chapter, we use ‘N(M)’ as a shorthand for 31 October 2004, the date when we begin to regulate mortgage lending, administration and mediation. ‘N(GI)’ refers to 14 January 2005 which is the date we start to regulate insurance mediation. We use ‘N(M&GI)’ when we mean both dates.

## **Periodic fees 2004/05 and tariff bases**

5.2 **Background:** We based the proposed ‘stub’ periodic fee rates on the actual income data we received up to April in applications for the newly-regulated activities, and on assumptions of the total expected numbers. We intended to make actual fee rates in this Policy Statement and said in CP04/9 that we would correct any over- or under-recovery in 2004/05 in the costs we recover within three years of N(M&GI) (paragraph 2.16 of CP04/9). In addition, we recognised that the final 2004/05 fee rates could vary materially from those we consulted on in CP04/9. We asked:

Q1: Do respondents agree with our proposed 2004/2005 periodic fees for the newly regulated activities? Do respondents have any comments on the draft rules in Annex 4?

5.3 **Consultation response:** We received 28 responses to the CP in total, 22 of which commented specifically on the periodic fees. Respondents generally

welcomed the proposed tariff bases and tiered fee rates for the new fee-blocks. Nine respondents said that the proposed fee rates were too high, particularly when compared to existing regulatory costs. We received a number of comments about the levels of income in certain fee bands. Respondents also noted that fee rates could not be accurately calculated until we have firmer knowledge about the number of firms in each of the new fee-blocks.

- 5.4 A small number of credit unions were concerned that the suggested fee rates for the A.19 fee-block were too high, relative to the size of most credit unions and the volume of insurance business that they are likely to transact. They suggested that regulatory fees should reflect the fact that credit unions give consumers with low income access to insurance products.
- 5.5 Some respondents requested an indication of the 2005/06 fee rates, the make-up of the fee-blocks and fee tariff data earlier than January 2005 so they can budget for regulatory fees. Two respondents considered the fifth fee-band (£15 million to £100 million) in A.19 to be too wide. One respondent disagreed with the tariff base we proposed for our A.2 fee-block (number of mortgages entered into and administered) as it includes unregulated mortgage contracts. Another respondent disagreed that reinsurers carrying on mediation activities should pay a fee in the A.19 fee-block, as they will not be subject to conduct of business regulation.
- 5.6 **Our response:** We recognise the importance to firms of accurate periodic fee rates and that firms want to know the costs of regulation before we start to regulate mortgage business and general insurance mediation. The proposed rates in CP04/9 and the data and assumptions they are based on remain valid and useable for firms' planning and budgeting purposes. However, it is important that we minimise the risk of a significant difference between the 2004/05 fee rates and those in future years, particularly in A.19 (general insurance mediation) where we expect to receive additional applications nearer N(GI). **Having considered the volume of applications received to date, the spread of income on applications received, and the responses to CP04/9, we intend to make the 'stub' periodic fee rates in January 2005 at the same time as we consult on 2005/06 periodic fees.** By then, we expect to have clearer and more complete data for each new fee-block. This will enable us to set more accurate fee rates for the new fee-blocks.
- 5.7 In addition, firms will be aware from our previous consultations that from 2005/06, costs will be allocated to each of the new fee-blocks individually, rather than to all three fee-blocks in proportion to the application fee income reported in each. By deferring making the 'stub' fee rates until January 2005, we can ensure that if we collect too much or too little, we will be able to adjust the periodic fees we set for the appropriate fee-block(s) within three years from 2005/06.
- 5.8 As stated in CP04/9, firms will not be invoiced for 'stub' periodic fees until we issue the invoices for 2005/06 fees in June 2005. In the meantime, paragraphs 5.9 to 5.15

below set out our feedback on the consultation responses received, so that firms can see how we are addressing these.

- 5.9 Regarding credit unions' concerns, we will consider this point in our January 2005 consultation on 2005/06 fees. Following our proposal in CP04/9, from 2005/06 a firm in multiple fee-blocks will obtain a discount in a fee-block where it is liable to pay the minimum fee only, unless it pays minimum fees in all fee-blocks. In that case, the firm will be liable for 100% of the highest minimum fee and 50% of the other(s) (see paragraph 6.24 to 6.26). Credit unions transacting only small amounts of insurance mediation business will be minimum fee payers in A.19, as well as in A.1 (deposit acceptors), so will potentially benefit from this arrangement. The proposed minimum 'stub' fee in the A.19 fee-block was £100 (for the period between N(GI) and 31 March 2005), amounting to £500 for the full year 2004/05. However, we explained in paragraph 2.26 of CP04/9 that A.19 annual periodic fee rates may change materially when they are made for 2005/06. We will review minimum fee levels as part of our fee-modelling for 2005/06 fees.
- 5.10 We are unable to provide indicative fee rates earlier than January as we will not have allocated our 2005/06 costs to each of the new fee-blocks. We will do this as part of our normal costing system and budget process for all fee-payers. We consult each January on the amount of our annual funding requirement to be recovered from each fee-block in the next financial year. Details are in our CPS<sup>4</sup>, available on our website at: [www.fsa.gov.uk/pubs/](http://www.fsa.gov.uk/pubs/).
- 5.11 The 2005/06 fees for the new fee-blocks will therefore be based on updated population data and periodic fee tariff data from applications received up to December. We will consult on fee rates for all fee-payers in our January 2005 consultation, although firms will not be invoiced for the newly regulated activities until June 2005 onwards.
- 5.12 With regard to the fee-banding in the A.19 fee-block, we consulted on proposed fee bands in CP04/9 based on available numbers and income data and assumptions in April. We will review the fee banding in the light of the updated income data on applications received to December and assess whether any adjustment should be made.
- 5.13 We believe the tariff base for the A.2 fee-block remains appropriate. Early consultations<sup>5</sup> on the A2 tariff base referred to the number of regulated mortgage contracts but, as explained in PS192<sup>6</sup>, we will base periodic fees on all mortgages rather than only regulated mortgage contracts until 2006. This tariff data is readily available to firms and avoids the need for new data collection requirements, and therefore additional costs to firms. From 2006/07 onwards, we will review whether the tariff base for mortgage lending and administration should revert to the narrower definition of 'regulated mortgage contract'.

---

4 PS04/15 'Consolidated policy statement on our fee-raising arrangements' (May 2004).

5 For example, in CP111 'Fourth consultation paper on the FSA's post-N2 fee-raising arrangements including feedback on CP95' (September 2001).

6 PS192 'Further consultation on fees for mortgage firms and insurance intermediaries – feedback and made text from CP192' (December 2003).

- 5.14 We did not consider fees in respect of reinsurance mediation in our previous consultations. Paragraph 3.20 explains that reinsurers will not be subject to Insurance: Conduct of Business sourcebook rules. As the fee rules stand, firms carrying on reinsurance will fall into our A.3 (Insurers – general) and A.19 (General insurance mediation) because they will need permission to arrange reinsurance contracts. We do not expect to incur any additional regulatory costs for reinsurers who arrange reinsurance contracts themselves, without going through an intermediary. However, a key principle in our fee-raising arrangements is that firms must pay at least a minimum fee for each fee-block they are in, even though they do not actually carry on any regulated activities covered by a fee-block.
- 5.15 We have therefore made the A.19 tariff-base rules that we consulted on in CP04/9 without any change. Regarding the A.19 fee-levels for reinsurers, we will consult on the 2005/06 fee rates in our January fees CP together with those for all fee-blocks.

### **Designated professional bodies (fee-block D)**

- 5.16 **Background:** We proposed recovering set-up costs of £50,000 from DPBs in 2005/06, in respect of the Register of exempt professional firms carrying on incidental insurance mediation. These costs represent an estimated one-third of the total set-up costs that we will recover from DPBs over three years from 2005/06. We intend to recover the remaining establishment costs from DPBs in 2006 and 2007.
- 5.17 **Consultation response:** One DPB replied specifically on this proposal, welcoming our approach to recovering the set-up costs of the Register of exempt professional firms.
- 5.18 **Our response:** We have made the rule in our Professional Firms sourcebook as proposed. We will continue to liaise with DPBs regarding the development costs of the Register.

### **Application fees post-N(M&GI)**

- 5.19 **Background:** We consulted on charging flat rate application fees for M&GI authorisation after regulation starts, according to the complexity of the application, in line with our usual policy. We asked:
- Q2: Do respondents agree with our proposed post-N(M&GI) application fees for the newly regulated activities?
- 5.20 **Consultation responses:** Of the 11 respondents who addressed this question, the majority agreed with our intended approach. Most found the application fees proportionate and welcomed the ‘straightforward’ classification of applications for insurance mediation. One respondent viewed the £1,500 application fee for insurance mediation as a disincentive to intermediaries to apply for regulation.

- 5.21 **Our response:** We maintain that the level of application fees for insurance mediation is appropriate to recover some of our costs in considering those applications, and we have made the application fees rules as proposed. As explained in the CPS<sup>7</sup>, application fees are set at levels below the full costs of processing applications, to reduce barriers to entry for new applicants. We will continue to review annually the appropriateness of application fee levels.

### **What happens next?**

- 5.22 We have made the rules on annual income, and the relevant valuation dates for the A.2, A.18 and A.19 fee-blocks. So firms will know before N(M&GI) what we will base their 'stub' and 2005/06 periodic fees on for the newly-regulated activities. We will make the rules setting the 2004/05 fee rates in January, using up-to-date population and income data from applications received. At that point, individual firms will be able to calculate their fees for the 'stub' period. M&GI firms' 2005/06 fees will be based on the income data stated on their application forms for authorisation/variation of permission. Firms will be invoiced for 'stub' and 2005/06 fees from June 2005 onwards, so will have some months to budget for the 'stub' fees.

---

7 PS04/15 'Consolidated policy statement on our fee-raising arrangements' (May 2004).

# 6 Other fee policy proposals affecting authorised firms

- 6.1 In Chapter 3 of CP04/9, we set out policy proposals – some that applied to firms intending to conduct mortgage business and insurance mediation but were also relevant to other fee-payers. We consulted on a definition of ‘income’ for the A.12 and A.13 fee-blocks, to replace the approved persons tariff base. CP04/9 also proposed discounts for firms in multiple fee-blocks and a small change to the description of the A.13 fee-block concerning client money held for insurance mediation purposes.

## Replacing the approved persons tariff base

- 6.2 **Background:** Following CP 04/2, we concluded that for firms in our A.12 and A.13 fee-blocks income is a fair and more appropriate measure of firms’ ‘size of business’ than the number of approved persons<sup>8</sup>. As stated in CP04/9, it is not our intention to increase the overall revenue we get from fees in those blocks. The aim of altering the ‘size of business’ measure in the A.12 and A.13 fee-blocks is to redistribute the costs of those fee-blocks according to the amount of business firms actually do, rather than simply their capacity.
- 6.3 CP04/9 contained draft rules defining ‘income’ on which A.12 and A.13 fees would be based. We asked:
- Q3: Do respondents have any comments on the draft income tariff base rules in Annex 5? What are respondents’ views on the reporting and systems implications of an income measure?
- 6.4 Out of the 28 respondents to CP04/9 in total, 12 replied specifically to this question. Before and during the consultation period, we also conducted a survey of A.12 and A.13 fee-payers to collect data on income from investment business, and comments on the practical issues in identifying and reporting

---

<sup>8</sup> ‘Approved persons’ in the context of A.12 and A.13 fees means only those with Controlled Functions 21, 22, 24, 25 and 26.

income data for fees purposes. In total, we had 1,500 survey responses, providing income data and several useful comments on the move to an income measure. This comprises income data for 26% of the total A.12 population and 20% of all A.13 fee-payers. This data enabled us to carry out fees modelling, to determine whether resulting fee levels based on firms' 'income' would be comparable with current fee levels on the present tariff base of numbers of approved persons. **We are extremely grateful to the trade bodies that helped us with the survey, and all the individual firms who took the time to reply.** They also provided invaluable insights into the practical implications of adopting an income measure for fees. We have taken these into account, together with the CP04/9 responses. Paragraphs 6.21 – 6.23 set out the outcome of the fee modelling.

- 6.5 In light of the comments we received on CP04/9 proposals and our income survey, we think that, while we could further clarify the income data we will base A.12 and A.13 fees on, we are not confident that income could be consistently reported between the firms in each fee-block. This would be essential to setting sufficiently accurate (and potentially more volatile) fee-rates each year, so that we can be reasonably certain of recovering the necessary proportions of our annual funding requirement from the A.12 and A.13 fee-payers.
- 6.6 **We have therefore decided not to adopt an income measure for A.12 and A.13 fees in 2005/06. However, we will keep the matter under review, and continue to provide input into the development of integrated regulatory reporting, which may help us develop this policy in the future.**
- 6.7 **Although we are not adopting an income measure in 2005/06, we believe it is still helpful for future policy development to provide feedback on the responses relating to the definition of 'income' and practical issues. Firms can therefore see in more detail the issues that would need to be overcome before we could implement an income tariff base. Paragraphs 6.14 – 6.20 address the responses we received.**
- 6.8 In the meantime, we are aware that many A.12 and A.13 firms will also be carrying on the newly-regulated M&GI activities, for which they will also be allocated to the A.18 and/or A.19 fee-block(s). Based on the present volume of applications for authorisation/variation of permission to carry on M&GI business, this affects 22% of A.12 fee-payers and 61% of A.13 fee-payers. We recognise those firms could potentially be disadvantaged by an approved persons tariff base in the A.12 and A.13 fee-blocks. This is because the A.18 and A.19 fees are calculated according to income, reflecting that the newly-regulated activities are not totally subject to the approved persons regime. Paragraphs 6.24 – 6.26 set out the discount we are introducing following CP04/9, for firms paying the minimum fees in multiple fee-blocks, which will assist firms doing small amounts of business.

- 6.9 **Consultation responses:** The majority of respondents supported the outcome of CP04/2 that, in principle, an income measure is a fairer way of measuring firms' 'size of business' in the A.12 and A.13 fee-blocks.
- 6.10 *Income tariff base:* In response to the survey, a number of firms asked for further clarity on whether 'income' included dealing profit and income from proprietary trading. Several respondents, mainly those carrying on wholesale investment business, said they would have practical difficulty in accurately identifying and reporting the type of income that we would need for fees purposes. On the other hand, most personal investment firms who responded said it would be straightforward for them to identify fees, commission and other related income from A.12 and A.13 activities. This reflects the large extent to which they carry on those activities, compared to other business.
- 6.11 *Data collection and reporting:* The practical implications of income data reporting attracted the most comments (both positive and negative), from CP04/9 and survey respondents alike. We said in paragraph 3.7 of CP04/9 that we considered it reasonable for firms to identify the income from A.12 and A.13 activities, if that resulted in more accurate fees. We intended to align fee data reporting requirements with those for supervision purposes as far as possible, to minimise the additional burden on firms of reporting new data sets to us. Our view was that many firms would want to monitor their income from different activities as a matter of good business practice. From the comments received, we identified a number of significant issues involving investment managers, wholesale market brokers, investment banks and stockbrokers. They identified the following practical concerns in collating and reporting the income data we would need for fees purposes:
- Accurately identifying and reporting the income generated from investment business (within the A.12 and A.13 fee-block descriptions) done in the UK only, as distinct from profits reported in the UK from business booked overseas and vice versa;
  - differing practices between firms in recording income against different business areas, for example between traders and sales forces. This risks double-counting business already accounted for in firms' A.10 (firms dealing as principal) fees. This is one of the main flaws we sought to address by moving to an income measure in the A.12 and A.13 fee-blocks; and
  - uncertainty in knowing whether a firm with the capacity to take a position has acted as matched principal broker in each transaction (and therefore whether firms should report income from that activity).
- 6.12 *Authorised professional firms:* We received mixed responses from DPBs on our proposals for authorised professional firms' (APFs) fees. Two DPBs noted that under this proposal, APFs would pay fees relating to non-mainstream activities that pose low risks to our statutory objectives, and it would be

disproportionate to separate those from mainstream regulated activity. Their preference was for 'income' to be based on revenue only from mainstream regulated activity. APFs were concerned that they could not always clearly distinguish, in a single transaction with a client or from their management information, when they were conducting mainstream activity as opposed to non-mainstream, and the resulting income. A few respondents also requested further guidance on what was meant by 'net income' and how we would treat commission equivalent paid by providers to their representatives.

6.13 *Fee levels:* Respondents across the board were concerned about the impact of an income measure on the fee amounts they would pay. In particular, firms carrying on wholesale market activities commented that fee levels based on income should reflect the lower risk they pose to our statutory objectives and our resulting 'light touch' regulation.

6.14 **Our response:** *Income tariff base:* Under an income measure, firms will necessarily have to contend with greater volatility and uncertainty about fee levels from year to year. We therefore recognise the importance of having a clearly defined and consistent tariff base that applies fairly to the wide variety of firm types within the A.12 and A.13 fee-blocks. Our general policy intention is to put all firms within the same fee-block on a level playing field when setting their fees. In moving to an income measure for fees, our intention was to base the A.12 and A.13 fees on annual income derived from all the regulated activities for which firms are allocated to those fee-blocks. Firms should not deduct their business expenses and overheads from the 'income' they would report for A.12 and A.13 fees.

6.15 The A.12 and A.13 fee-blocks cover firms whose permission includes dealing in designated investments as agent and dealing as principal where the activity is carried on as a matched principal broker, oil market participant, energy market participant or local. Our view is that 'income' should include dealing profit earned from those activities because firms are allocated to either the A.12 or A.13 fee-block as a result of their permission to do those activities. We would then be treating all firms consistently within the same fee-block. So income would include 'dealing profit' where this was earned from the dealing activities mentioned above.

6.16 Unlike the fees in the A.10 fee-block (firms dealing as principal) A.12 and A.13 fees would cover dealing in investments where firms have not taken a position. So there would be no duplication of fees between the A.10 and A.12 or A.13 fee-blocks. Regarding income from proprietary trading, we intended to base fees on income derived from designated investment business done with clients. As proprietary trading only affects the firm's own account, 'income' for A.12 and A.13 fees would exclude profit derived from that activity.

6.17 *Authorised professional firms:* We proposed basing A.12 and A.13 fees on income that APFs earn from all their regulated activities, whether mainstream or non-mainstream.

This would align income reporting for fees with APFs' financial reporting requirements for supervisory purposes.

- 6.18 We consider that our reasons for defining 'income' as that derived from both mainstream and non-mainstream activities remain valid. As stated in paragraph 3.5 of CP04/9, it would be anomalous for all APFs to report income from their mainstream regulated activities only, as many APFs in the A.13 fee-block are conducting purely non-mainstream activities. Reporting all income for fees would accord with integrated regulatory reporting requirements for APFs conducting retail investment activity, which do not require any distinction between mainstream and non-mainstream activities. So APFs would not incur the extra costs and burden of identifying income from mainstream activity for fees purposes only, particularly when the extent of non-mainstream activity could be very low. However, we may consider allowing APFs that hold client money to report only mainstream activity income for their A.12 fees. They would be free to include non-mainstream activity income if it would be disproportionate to exclude it.
- 6.19 *Data collection and reporting:* Generally, A.12 and A.13 firms already have to report a figure for fees, commission and brokerage for supervision purposes. We considered whether this regulatory reporting could be a basis for A.12 and A.13 fees. However, we recognise that some firm types in the A.12 and A.13 fee-blocks have more complex sources of income than others. In particular, we are mindful of the potential additional burden to many non-personal investment firms of requiring them to build systems to collect the income data we would need, purely for fees purposes. In addition, many authorised firms within groups have waivers from financial reporting requirements as group reports are considered sufficient. So we do not have consistent existing income data from all individual entities in the A.12 and A.13 fee-blocks, which we would need because fees are payable on an entity – rather than a group – basis.
- 6.20 *Fee levels:* As we are not setting fee rates based on income in 2005/06 we are not modelling indicative fee rates. So we cannot yet fully address concerns about fee levels. We will however consider whether the minimum fee discount (see paragraphs 6.24 – 6.26) addresses the potential disadvantage to those A.12 and A.13 firms who are liable for more than the minimum fee in the A.18 and/or A.19 fee-block(s). In addition, we will review whether it would be appropriate to continue the discounts for authorised professional firms in the A.12 and A.13 fee-blocks. This was originally intended to be a transitional arrangement only<sup>9</sup>. The discount reflects the restrictions imposed by professional rules on how much time approved persons in authorised professional firms can spend doing investment business. We will report on both these issues in our January 2005 fees paper.

---

9 'Consolidated policy statement on the FSA's general policy framework for raising fees – Feedback up to and including CP168' (May 2003)

- 6.21 **Fee modelling:** Chapter 6 of our CPS sets out the main principles of the tariff rates we set for most fee-blocks. Two factors that we take into account in setting fee rates are range of, and distribution by, size of fee-payers. We carried out fee-modelling using data from the income survey, aiming to set indicative fee rates for firms according to the amount of income they generated from investment business activities within the A.12 and A.13 fee-block descriptions. Ultimately, we aimed to keep fee rates similar to – or lower than – current levels for the majority of firms, while collecting the same revenue from each fee-block. There will inevitably be higher rates for a number of firms. To do this, we analysed whether a close correlation could be established between number of approved persons and income in most cases, which would enable us to identify appropriate fee bands and rates per band.
- 6.22 From survey data we were able to establish a sufficiently clear correlation between income and number of approved persons for 39% of the A.12 population. However, this sector accounts for £4.05 million in revenue – only 16% of the total annual funding requirement to be recovered from the A.12 fee-block. We do not consider this robust enough to set tariff rates that will not result in higher fee levels for the majority of firms.
- 6.23 In the A.13 fee-block, we found a strong relationship between income and approved persons for Independent Financial Advisers (IFAs) and APFs, who make up 73% and 5% of the fee-block respectively and together account for £23.3 million – 65% of the A.13 total costs. So it is likely that a tariff rate could have been set for the majority of firms in the A.13 fee-block based on income. However, the remaining population comprises non-personal investment firms, who would face the practical data reporting issues outlined above. We consider that there would be significant risk that we would not collect the amount we need from a large proportion of the A.13 population each year. This could result in higher and less predictable A.13 fee rates each year.

### **Discounts for firms in multiple fee-blocks**

- 6.24 **Background:** We proposed that from 2005/06, firms in more than one fee-block would benefit from a 50% discount in any fee-block in which it is liable for only the minimum fee. If the firm is liable for the minimum fee only in all fee-blocks it belongs in, it will pay 100% of the highest fee and 50% of the others. We asked:
- Q4. Do respondents have any comments on our proposed relief for firms falling in more than one fee-block?
- 6.25 **Consultation responses:** The majority of respondents welcomed this proposal. Two respondents commented that it was unfair to general insurers in both our A.3 and A.19 fee-blocks. They thought it would result in insurers subsidising A.19 fees.

6.26 **Our response:** We explained in a previous policy statement<sup>10</sup> why insurers who also carry out insurance mediation will be in the A.19 fee-block. In light of these responses, we have made the rule to implement the proposal unchanged.

### **A.13 fee-block – client money held for general insurance mediation purposes**

6.27 **Background:** We consulted on a small change to the A.13 fee-block description. The effect is that allocation to the fee-block will not change if a firm holds client money solely for the purposes of insurance mediation. We asked:

Q5 Do respondents agree with our proposal to amend the A.13 fee-block definition?

6.28 **Consultation response:** We received no significant comments on this proposal and have therefore made this change.

---

10 PS192 'Further consultation on fees for mortgage firms and insurance intermediaries – Feedback and made text from CP192' (December 2003)

# List of non-confidential respondents to CP04/4

Alexander Forbes Risk Services UK Ltd  
Alliance & Leicester plc  
Association of British Insurers (ABI)  
Association of Mortgage Intermediaries (AMI)  
Aon  
Aviva plc  
BDML Connect Ltd  
Brit Insurance  
Britannia Building Society  
Broadstone (IFA) Ltd  
Create Solutions Ltd  
David Haskoll Ltd  
Finance & Leasing Association (FLA)  
Firebond plc  
Friends Provident  
Financial Services Consumer Panel  
General Insurance Standards Council (GISC)  
Independent Mutual Ltd  
Institute of Insurance Brokers (IIB)  
Jardine Lloyd Thompson  
Lloyd's Market Association (LMA)  
London Market Insurance Brokers' Committee (LMBC)  
Misys General Insurance  
National Consumer Federation  
Norwest Consultants  
Opus London Market Ltd

Prudential Assurance Company Ltd  
Retail Motor Industry Federation  
Sabre Insurance Company Ltd  
Small Business Practitioner Panel  
T H March & Co Ltd  
Zurich Financial Services

We also received two responses which requested that we keep their replies confidential. Nevertheless, we have taken the responses into account in finalising our rules.

# List of non-confidential respondents to CP04/9

Alexander Forbes Risk Services UK Ltd  
Association of British Credit Unions Ltd  
Association of British Insurers  
AXA Insurance  
Barclays Bank Plc  
Beckett Financial Services Limited  
Belgravia Financial and Mortgage Services  
Finance Matters (NI)  
Fish Insurance  
Friends Provident Life and Pensions Limited  
FSA Small Business Practitioner Panel  
GFI Group  
Halifax Plc  
Handsworth Breakthrough Credit Union Limited  
ICAP plc  
Joint Investment Business Committee (of ICAEW, ICAS and ICAI)  
London Investment Banking Association  
London Society of Chartered Accountants  
Misys General Insurance  
Mortgages Made Easy!  
Retail Motor Industry Federation  
Ronald S Rankine & Co Ltd  
Scottish Police Credit Union Ltd  
The Law Society of Scotland  
Zurich Financial Services Limited

We also received three responses which requested that we keep their replies confidential. Nevertheless, we have taken the responses into account in finalising our rules.



# Made Text for DISP, COMP & Handbook Glossary

**COMPLAINTS AND COMPENSATION SOURCEBOOKS (MORTGAGE AND  
GENERAL INSURANCE INTERMEDIARIES FUNDING OF THE OMBUDSMAN  
AND COMPENSATION SCHEMES) INSTRUMENT 2004**

**Powers exercised**

- A. The Financial Services Authority 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 138 (General rule-making power);
  - (2) section 156 (General supplementary powers);
  - (3) section 213 (The compensation scheme);
  - (4) section 214 (General);
  - (5) section 223 (Management expenses); and
  - (6) section 234 (Industry funding).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force as follows:
- (1) The amendments in Annexes A, B and C come into force on 31 October 2004;
  - (2) The amendments in Annex D come into force on 14 January 2005.

**Amendments to the Dispute resolution: Complaints sourcebook**

- D. The Dispute resolution: Complaints sourcebook is amended in accordance with Annex A to this instrument.

**Amendments to the Compensation sourcebook**

- E. The Compensation sourcebook is amended in accordance with Annexes B and D to this instrument.

**Amendments to the Glossary**

- F. The Glossary is amended in accordance with Annex C to this instrument.

**Citation**

- G. This instrument may be cited as the Complaints and Compensation Sourcebooks (Mortgage and General Insurance Intermediaries Funding of the Ombudsman and Compensation Schemes) Instrument 2004.

By order of the Board  
20 October 2004

## Annex A

### Amendments to the Dispute Resolution: Complaints sourcebook

In this Annex, underlining indicates new text.

DISP Table Transitional Provisions table

1

(1)	(2)	(3)	(4)	(5)	(6)
	Material provision to which transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision coming into force
	...				
<u>15</u>	<u>DISP 5.5.1R</u>	<u>R</u>	A <i>firm</i> which falls within <i>industry block 16</i> or <i>17</i> needs to provide a statement to the <i>FSA</i> by the end of <u>February 2005</u> only if it is providing the <i>FSA</i> with a statement of the total amount of <u>relevant business</u> .	<u>31 October 2004</u> to <u>28 February 2005</u> for <i>firms</i> falling in <i>industry block 16</i>  <u>14 January 2005</u> to <u>28 February 2005</u> for <i>firms</i> falling in <i>industry block 17</i>	<u>31 October 2004</u>
<u>16</u>	<u>DISP 5.5.1R</u>	<u>G</u>	In respect of the year <u>2005/06</u> , the <i>FSA</i> will already have a statement of the total amount of the <i>firm's</i> annual income as part of the <i>firm's</i> application for a <i>Part IV permission</i> or to vary a <i>Part IV permission</i> . <u>There is thus no need for a <i>firm</i> to repeat this information if it decides not to report annual income for relevant business in accordance with <i>DISP TP 15R</i>.</u>	<u>31 October 2004</u> to <u>28 February 2005</u> for <i>firms</i> falling in <i>industry block 16</i>  <u>14 January 2005</u> to <u>28 February 2005</u> for <i>firms</i> falling in <i>industry block 17</i>	<u>31 October 2004</u>

...

5.4.10 R For the purpose of *DISP 5.4*, references to *relevant business* for a *firm* which falls in *industry block 16 or 17* and which so elects under part 2 of *DISP 5 Ann 1R*, are references to the *firm's* total amount of annual income reported in accordance with Part 2 of *SUP 20 Ann 1R*.

...

5.5.1 R (4) For the purpose of *DISP 5.5.1R*, references to *relevant business* for a *firm* which falls in *industry block 16 or 17* and which so elects under part 2 of *DISP 5 Ann 1R*, are references to the *firm's* total amount of annual income reported in accordance with Part 2 of *SUP 20 Ann 1R*.

DISP 5 Ann 1R

...

2 Table: ~~Table:~~ fee tariffs for industry blocks

Industry block	Tariff base	General levy payable by firm
...		
<u>16 – Mortgage lenders, advisers and arrangers (excluding firms in blocks 13, 14 &amp; 15)</u>	<u>Either annual income reported in accordance with Part 2 of SUP 20 Ann 1R from relevant business or the firm's total annual income reported in accordance with Part 2 of SUP 20 Ann 1R</u>	<u>No levy is payable for 2004/2005</u>
<u>17 – General insurance mediation (excluding firms in blocks 13,14 &amp; 15)</u>	<u>Either annual income reported in accordance with Part 2 of SUP 20 Ann 1R from relevant business or the firm's total annual income reported in accordance with Part 2 of SUP 20 Ann 1R</u>	<u>No levy is payable for 2004/2005</u>

## Annex B

### Amendments to the Compensation sourcebook

In this Annex underlining indicates new text.

COMP Table: Transitional Provisions Table

1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional Provision	(5) Transitional provision: dates in force	(6) Handbook Provisions coming into force
...					
<u>10</u>	<u>COMP 5.7.1R, 13.4.7BR and 13.6.9BR</u>	<u>R</u>	<u>Rules not in effect.</u>	<u>31 October 2004 to 13 January 2005</u>	<u>31 October 2004</u>
<u>11</u>	<u>COMP 13.4.1R, 13.4.19R, 13.5.6R, 13.5.8R, 13.6.1R and 13.6.6R</u>	<u>R</u>	<u>With regard to <i>contribution group A.18 – Mortgage lenders, advisers and arrangers, the management expenses levy and compensation costs levy</i> for 2005/2006 may also take account of expenditure in the period 31 October 2004 to 31 March 2005.</u>	<u>31 October 2004 to 31 March 2006</u>	<u>31 October 2004</u>
<u>12</u>	<u>COMP 13.4.1R, 13.4.19R, 13.5.6R, 13.5.8R, 13.6.1R and 13.6.6R</u>	<u>R</u>	<u>With regard to <i>contribution group A.19 – General insurance mediation, the management expenses levy and compensation costs levy</i> for 2005/2006 may also take account of expenditure in the period 14 January 2005 to 31 March 2005.</u>	<u>14 January 2005 to 31 March 2006</u>	<u>31 October 2004</u>

13	<u>COMP 13.6.7 (4) 13.6.9A R and 13.6.11R(2)</u>	R	For the period 31 October 2004 to 31 March 2006 the tariff base will be the annual income (relating to the relevant <i>contribution group</i> ) reported in accordance with note 3 to <i>AUTH 4 Ann 2</i> or, if the <i>firm</i> prefers, that amount of its annual income which is attributable to business conducted with <i>eligible claimants</i> but only if the <i>firm</i> notifies <i>FSCS</i> of the amount by 28 February 2005.	31 October 2004 to 31 March 2006	31 October 2004
14	<u>COMP 13.6.7(5), 13.6.9B R and 13.6.11R(2)</u>		For the period 14 January 2005 to 31 March 2006 the tariff base will be the annual income (relating to the relevant <i>contribution group</i> ) reported in accordance with note 3 to <i>AUTH 4 Ann 2</i> or, if the <i>firm</i> prefers, that amount of its annual income which is attributable to business conducted with <i>eligible claimants</i> but only if the <i>firm</i> notifies <i>FSCS</i> of the amount by 28 February 2005.	14 January 2005 to 31 March 2006	31 October 2004

...

5.7.1 R *Protected non-investment insurance mediation* is an *insurance mediation activity* where the *investment* concerned is a *non-investment insurance contract* which is not a *reinsurance contract*, provided that the condition in *COMP 5.7.2R* is satisfied.

...

13.4.7A R The *FSCS* must not require a *participant firm* in the mortgage advice and arranging *sub-scheme* to pay a share of a *compensation costs levy* allocated to that *sub-scheme* in any financial year of the *compensation scheme*, to the extent that:

- (1) the share in question; plus
- (2) all previous amounts paid by the *firm* as its share of *compensation costs levies* allocated to that *sub-scheme* in that financial year;

amounts to more than 0.8% of the *participant firm's annual eligible income*.

13.4.7B R The *FSCS* must not require a *participant firm* in the general insurance mediation *sub-scheme* to pay a share of a *compensation costs levy* allocated to that *sub-scheme* in any financial year of the *compensation scheme*, to the extent that:

- (1) the share in question; plus
- (2) all previous amounts paid by the *firm* as its share of *compensation costs levies* allocated to that *sub-scheme* in that

financial year;  
amounts to more than 0.8% of the *participant firm's annual eligible income.*

- ...  
 13.6.7 R ...  
 (3) ... ;  
 (4) the mortgage advice and arranging *sub-scheme*, the FSCS must use the *contribution group* and tariff base set out in the table in COMP 13.6.9AR;  
 (5) the general insurance mediation *sub-scheme*, the FSCS must use the *contribution group* and tariff base set out in the table in COMP 13.6.9BR.

...  
 13.6.9AR Table: the contribution groups and tariff bases for the mortgage advisers and arrangers (see COMP 13.6.7R(4))

<u>SUB-SCHEME</u>	<u>CONTRIBUTION GROUP (REFERENCE S TO A1, A2 ETC ARE TO THE FSA FEE BLOCKS)</u>	<u>LEGAL BASIS FOR ACTIVITY (references to articles are to articles of the <i>Regulated Activities Order</i>)</u>	<u>TARIFF BASE</u>
<u>Mortgage advice and arranging</u>	<u>A.18 – Mortgage lenders, advisers and arrangers</u>	<u>Any of the following: (a) <i>arranging (bringing about) regulated mortgage contracts</i>; (b) <i>making arrangements with a view to regulated mortgage contracts</i>; (c) <i>advising on regulated mortgage contracts</i>; (d) <i>agreeing to carry on a regulated activity which is within any of the above</i>; and (e) the activities of a <i>mortgage lender</i> which would be <i>arranging</i> but for article 28A of the <i>Regulated Activities Order (Arranging contracts to which the arranger is a party)</i>.</u>	<u><i>annual eligible income</i></u>

13.6.9B R Table: the contribution groups and tariff bases for the general insurance intermediaries (see COMP 13.6.7R(5))

<u>SUB-SCHEME</u>	<u>CONTRIBUTION GROUP (REFERENCES TO A1, A2 ETC ARE TO THE FSA FEE BLOCKS)</u>	<u>LEGAL BASIS FOR ACTIVITY (references to articles are to articles of the <i>Regulated Activities Order</i>)</u>	<u>TARIFF BASE</u>
<u>General insurance mediation</u>	<u>A.19 – General insurance mediation</u>	<u>Any of the following in relation to a <i>non-investment insurance contract</i>: (a) <i>dealing in investments as agent</i>; (b) <i>arranging (bringing about) deals in investments</i>; (c) <i>making arrangements with a view to transactions in investments</i>; (d) <i>assisting in the administration and performance of a contract of insurance</i>; (e) <i>advising on investments</i>; and (f) <i>agreeing to carry on a regulated activity which is within any of the above</i>.</u>	<u><i>annual eligible income</i></u>

## Annex C

### Amendment to the Glossary of definitions

In this Annex underlining indicates new text and strikethrough indicates deleted text.

Insert the following new definition in the appropriate alphabetical position:

*annual eligible income* (in *COMP*) the annual income (as described in Part 2 of *SUP 20 Ann 1R*) for the *firm's* last financial year preceding the date for submission of the information under *COMP16.6.11R* attributable to the relevant *contribution group*; or if the *firm* prefers, that amount of that annual income attributable to business conducted with *eligible claimants*, but only if the *firm* notifies *FSCS* of the amount in accordance with *FSCS* reporting requirements.

Amend the following definition as shown:

*sub-scheme* one of the ~~three~~ sub-schemes to which the *FSCS* allocates liabilities for *compensation costs* , as described in *COMP 13.6.7R*.

## Annex D

### Amendments to the Compensation sourcebook

In this Annex new sections of text are being inserted, so the place where the change will be made is indicated and the text is not struck through or underlined.

Insert the following new rule after *COMP* 3.2.3 R

- 3.2.4 R The *FSCS* may also pay compensation to a *firm*, who makes a claim in connection with *protected non-investment insurance mediation* on behalf of its *customers*, if the *FSCS* is satisfied that:
- (1) each *customer* has borne a *shortfall* in *client money* held by the *firm* caused by a *secondary pooling event* arising out of the *failure* of a broker or *settlement agent* which is a *relevant person in default*;
  - (2) the *customers* in respect of which compensation is to be paid satisfy the conditions set out in *COMP* 3.2.2R(1);
  - (3) the *customers* do not have a *claim* against the *relevant person* directly, nor a claim against the *firm*, in respect of the same loss;
  - (4) the *customers* would have been paid compensation by *FSCS* if the *customers* had a *claim* for their share of the *shortfall*, and if the *firm* were the *relevant person*; and
  - (5) the *firm* has agreed, on such terms as the *FSCS* thinks fit, to pay, or credit the accounts of, without deduction, each relevant *customer* in (1), that part of the compensation equal to the *customer's* financial loss, subject to the limits in *COMP* 10.2.

...

Insert the following new rule after *COMP* 6.3.7G:

- 6.3.8 R Claims arising under *COMP* 3.2.4R
- For the purposes of *COMP* 6.3 a claim made by a *firm* under *COMP* 3.2.4R is to be treated as if it were a *protected claim* against the *relevant person*.

...

Insert the following new rule after *COMP* 7.2.6G

- 7.2.7 R (1) For the purposes of compensation paid under *COMP* 3.2.4R, *FSCS* may require any *firm* (including, but not limited to, the claimant *firm*) to assign to *FSCS* any rights the *firm* may have to claim against the *relevant person* in relation to the amount of the *shortfall* in *client money* arising out of the *failure* of the *relevant person*.
- (2) A *firm* required by *FSCS* to assign its rights in (1), must assign those rights as requested, unless it has a reasonable

excuse for not doing so.

...

Insert the following new rule after *COMP* 10.2.8R

Claims arising under *COMP* 3.2.4R

- 10.2.9 R If a *firm* has a claim under *COMP* 3.2.4R, the *FSCS* must treat the share of the *shortfall* of each *customer* as if it were a *protected claim* for the purposes of calculating the limits of compensation payable, within *COMP* 10.2, in relation to that *customer*.

...

Insert the following new rule after *COMP* 12.6.11R

Claims arising under *COMP* 3.2.4R

- 12.6.12 R If a *firm* has a claim under *COMP* 3.2.4R, the *FSCS* must treat each *customer* of the *firm* as having the claim for the purposes of calculating compensation within *COMP* 12.



# Made Text for SUP, PROF & AUTH

**MORTGAGE FIRMS AND INSURANCE INTERMEDIARIES (FEES)  
INSTRUMENT 2004**

**Powers exercised**

- A. The Financial Services Authority 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 156 (General supplementary powers);
  - (2) section 157(1) (Guidance); and
  - (3) paragraph 17(1) of Schedule 1 (Fees).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

**Commencement**

- C. This instrument comes into force on 31 October 2004 (in part) and 14 January 2005 (in part). To the extent that a provision relates to any regulated activity in relation to a long-term care insurance contract or a regulated mortgage activity, it comes into force on 31 October 2004. Otherwise it comes into force on 14 January 2005.

**Amendments to the Supervision manual**

- D. The Supervision manual is amended in accordance with Annex A to this instrument.

**Amendments to the Professional Firms sourcebook**

- E. The Professional Firms sourcebook is amended in accordance with Annex B to this instrument.

**Amendments to the Authorisation manual**

- F. The Authorisation manual is amended in accordance with Annex C to this instrument.

**Citation**

- G. This instrument may be cited as the Mortgage Firms and Insurance Intermediaries (Fees) Instrument 2004.

By order of the Board  
20 October 2004

## Annex A

### Amendments to the Supervision manual

In this Annex underlining indicates new text, striking through indicates deleted text.

#### Transitional provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
...					
16	...				
17	<u>SUP 20.4.4R(4)</u>	<u>R</u>	<u>The periodic fee modification set out in SUP 20.4.4R(4) does not apply to the A.2, A.18 and A.19 activity groups until 1 April 2005.</u>	<u>From 31 October 2004 to 31 March 2005</u>	<u>1 April 2002</u>

...

SUP 20 Ann 1R

#### Activity groups, tariff bases and valuation dates applicable

##### Part 1

...

SUP Table:

2

Activity group	Fee-payer falls in the activity group if
...	...
<b>A.13 Advisory arrangers, dealers or brokers (not holding or controlling client money or assets, or both)</b>	<p>(1) it is an <i>authorised professional firm</i> and <b>ALL</b> the <i>regulated activities</i> in its <i>permission</i> are limited to <i>non-mainstream regulated activities</i>;</p> <p><b>OR</b></p> <p>(2) its <i>permission</i>:</p> <p>(a) includes one or more of the following, in relation to one or more <i>designated investments</i>:</p> <ul style="list-style-type: none"> <li>• <i>dealing in investments as agent</i>;</li> <li>• <i>arranging (bringing about) deals in investments</i>;</li> <li>• <i>making arrangements with a view to transactions in investments</i>;</li> <li>• <i>dealing as principal in investments</i> where the activity is carried on as a matched principal broker, <i>oil market participant</i>, <i>energy market participant</i> or <i>local</i>;</li> <li>• <i>advising on investments (except pension transfers and pension opt-outs)</i>;</li> <li>• <i>advising on pension transfers and pension opt-outs</i>;</li> </ul>

	<ul style="list-style-type: none"> <li>• <i>advising on syndicate participation at Lloyd's;</i></li> </ul> <p>(b) <b>BUT NONE</b> of the following:</p> <ul style="list-style-type: none"> <li>• <i>effecting contracts of insurance;</i></li> <li>• <i>carrying out contracts of insurance;</i></li> <li>• <i>safeguarding and administration of assets;</i></li> <li>• <i>arranging safeguarding and administration of assets;</i></li> </ul> <p><b>AND</b></p> <p>(c) <b>MUST EITHER</b>, in connection with its <i>designated investment business</i>:</p> <ul style="list-style-type: none"> <li>• have a <i>requirement</i> that prohibits the <i>firm</i> from holding or controlling <i>client money</i>, or both;</li> </ul> <p><b>OR</b></p> <ul style="list-style-type: none"> <li>• if it does not have such a <i>requirement</i>, only holds or controls <i>client money</i> (or both), arising from an agreement under which <i>commission</i> is rebated to a <i>client</i>;</li> </ul> <p>...</p>
...	...

...

**Part 2**

This table indicates the tariff base for each fee-block. The tariff base is the means by which we measure the 'amount of business' conducted by a *firm*.

<b>Activity group</b>	<b>Tariff-base</b>
...	...
<b>A.2</b>	<p>Not applicable. [Note: will be made to come into effect from 31 October 2004.]</p> <p><b><u>NUMBER OF MORTGAGES ENTERED INTO AND ADMINISTERED</u></b></p> <p><u>The number of new mortgage contracts entered into;</u></p> <p><b><u>AND</u></b></p> <p><u>The number of mortgage contracts being administered, multiplied by 0.5.</u></p> <p><b><u>Notes:</u></b></p> <p>(1) <u>For 2004/05 and 2005/06 firms have supplied this data on their 'HSF1' or 'variation of permission' application form.</u></p> <p>(2) <u>In this context a "mortgage" means a loan secured by a first charge over residential property in the <i>United Kingdom</i>. For the measure of the number of contracts being administered, each first charge counts as one contract, irrespective of the number of loans involved.</u></p> <p>(3) <u>Mortgages administered include those that the <i>firm</i> administers on behalf of other <i>firms</i>.</u></p>
...	...
<b>A.18</b>	<p>Not applicable. [Note: will be made to come into effect from 31 October 2004.]</p> <p><b><u>ANNUAL INCOME</u></b></p>

	<p>(a) <u>the net amount retained by the <i>firm</i> of all brokerages, fees, commissions and other related income (eg administration charges, overrides, profit shares) due to the <i>firm</i> in respect of or in relation to <i>mortgage mediation activity</i> (or activities which would have been <i>mortgage mediation activity</i> if they had been carried out after 30 October 2004);</u></p> <p><b><u>Plus</u></b></p> <p>(b) <u>for any <i>mortgage mediation activity</i> carried out by the <i>firm</i> for which it receives payment from the lender on a basis other than that in (a), the value of all new mortgage advances resulting from that activity multiplied by 0.004;</u></p> <p><b><u>Plus</u></b></p> <p>(c) <u>if the <i>firm</i> is a <i>mortgage lender</i>, the value of all new mortgage advances which are or would be <i>regulated mortgage contracts</i> if they had been made after 30 October 2004 (other than those made as a result of <i>mortgage mediation activity</i> by another <i>firm</i>), multiplied by 0.004.</u></p> <p><b><u>Notes on annual income:</u></b></p> <p>(1) <u>For 2004/05 and 2005/06 <i>firms</i> have supplied this data on their 'HSF1' or 'variation of permission' application form.</u></p> <p>(2) <u>For the purposes of calculating annual income, "net amount retained" means all the commission, fees, etc. in respect of <i>mortgage mediation activity</i> that the <i>firm</i> has not rebated to customers or passed on to other <i>firms</i> (for example, where there is a commission chain). Items such as general business expenses (eg employees' salaries, overheads) should <b>not</b> be deducted.</u></p> <p>(3) <u>The <i>firm</i> must include in its income calculation, on the same basis as above, earnings from those who will become its <i>appointed representatives</i> immediately after <i>authorisation</i>.</u></p> <p>(4) <u>Reference to a "<i>firm</i>" above also includes reference to any <i>person</i> who carried out activities which would be <i>mortgage mediation activity</i> if they had been carried out after 30 October 2004.</u></p>
A.19	<p>Not applicable. [Note: will be made to come into effect from 31 October 2004.]</p> <p><b><u>ANNUAL INCOME</u></b></p> <p>(a) <u>the net amount retained by the <i>firm</i> of all brokerages, fees, commissions and other related income (eg administration charges, overrides, profit shares) due to the <i>firm</i> in respect of or in relation to <i>insurance mediation activity</i> (or activities which would have been <i>insurance mediation activity</i> if they had been carried out after 13 January 2005) in relation to <i>general insurance contracts</i> or <i>pure protection contracts</i>;</u></p> <p><b><u>Plus</u></b></p> <p>(b) <u>in relation to the activities set out in (a), for any <i>insurance mediation activity</i> carried out by the <i>firm</i> for which it receives payment from the <i>insurer</i> on a basis other than that in (a), the amount of <i>premiums</i> receivable on the <i>contracts of insurance</i> resulting from that activity multiplied by 0.07;</u></p> <p><b><u>Plus</u></b></p> <p>(c) <u>if the <i>firm</i> is an <i>insurer</i>, in relation to the activities set out in (a), the amount of</u></p>

	<p><u>premiums</u> receivable on its <u>contracts of insurance</u> multiplied by 0.07, excluding those <u>contracts of insurance</u> which:</p> <p>(i) <u>result from insurance mediation activity</u> by another <u>firm</u>, where a payment has been made by the <u>insurer</u> to the <u>firm</u> under (a); or</p> <p>(ii) <u>the insurer</u> reports in, and pays a fee under, the A.4 activity group; or</p> <p>(iii) <u>are not general insurance contracts or pure protection contracts.</u></p> <p><b><u>Notes on annual income:</u></b></p> <p>(1) <u>For 2004/05 and 2005/06 firms</u> have supplied this data on their 'HSF1' or 'variation of permission' application form.</p> <p>(2) <u>For the purposes of calculating annual income</u>, "net amount retained" means all the <u>commission, fees, etc. in respect of insurance mediation activity</u> that the <u>firm</u> has not rebated to customers or passed on to other <u>firms</u> (for example, where there is a <u>commission chain</u>). Items such as <u>general business expenses</u> (eg employees' salaries, overheads) should <b>not</b> be deducted.</p> <p>(3) <u>The firm</u> must include in its income calculation, on the same basis as above, earnings from those who will become its <u>appointed representatives</u> immediately after <u>authorisation</u>.</p> <p>(4) Reference to a "<u>firm</u>" above also includes reference to any <u>person</u> who carried out activities which would be <u>insurance mediation activity</u> (in respect of <u>general insurance contracts or pure protection contracts</u>) if they had been carried out after 13 January 2005.</p>
...	...

### Part 3

This table indicates the valuation date for each fee-block. A *firm* can calculate its tariff data by applying the tariff bases set out in Part 2 with reference to the valuation dates shown in this table.

Activity group	Tariff-base
...	...
A.2	<p>Not applicable. [Note: will be made to come into effect from 31 October 2004.]</p> <p><u>Number of mortgages entered into in the twelve months ending 31 December.</u></p> <p><b><u>AND</u></b></p> <p><u>Number of mortgages being administered on 31 December.</u></p>
...	...
A.18	<p>Not applicable. [Note: will be made to come into effect from 31 October 2004.]</p> <p><u>Annual income (AI) for the financial year ended in the calendar year ending 31 December.</u></p>
A.19	<p>Not applicable. [Note: will be made to come into effect from 31 October 2004.]</p> <p><u>Annual income (AI) for the financial year ended in the calendar year ending 31 December.</u></p>
...	...

## Annex B

### Amendments to the Professional Firms sourcebook

In this Annex underlining indicates new text.

PROF 6 Ann 1R

...

Table: Fees payable by Designated Professional Bodies

...

Notes

- (1) The FSA register will include details of exempt professional firms carrying out insurance mediation activity.
- (2) In addition to the periodic fees shown above, the sum of £50,000 will be due from the designated professional bodies, divided between the bodies in proportion to the number of exempt professional firms each has on the FSA register on 14 January 2005. This is a contribution towards the costs of developing this part of the FSA register.
- (3) Each of the designated professional bodies will be invoiced for the appropriate amount in January 2005. The invoices must be paid on or before 28 February 2005.

## Annex C

### Amendments to the Authorisation manual

In this Annex underlining indicates new text.

AUTH 4 Ann 1R

...

#### Part 2 – Complexity Groupings

Straightforward cases

Activity grouping	Description
...	...
<u>A.18</u>	<u>Mortgage lenders, advisers and arrangers (excluding mortgage lenders)</u>
<u>A.19</u>	<u>General insurance mediation</u>

Moderately complex cases

Activity grouping	Description
A.1	<u>E-money issuers only</u>
<u>A.2</u>	<u>Mortgage lenders and administrators</u>
...	...

...



**ISBN: 1-84518-286-3**

The Financial Services Authority  
25 The North Colonnade Canary Wharf London E14 5HS  
Telephone: +44 (0)20 7066 1000 Fax: +44 (0)20 7066 1099  
Website: <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No. 1920623. Registered Office as above.