outlook

fscs

News from the Financial Services Compensation Scheme | April 2019

Compensating consumers since 2001

FSCS UPDATE

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CHIEF EXECUTIVE'S STATEMENT

Mark Neale, Chief Executive

"We know from our research that consumers who understand FSCS protection make different choices about the scale of their retirement saving and the products they buy."

This year our usual bulletin to the industry on FSCS's final levies for the year ahead – 2019/20 - coincides with important changes to the funding regime.

The changes to the pooling of FSCS's compensation costs proposed by the FCA Review come into effect. This means that insurance and investment providers are required to contribute to the costs of advice failures. Life, pensions and investment advisers are also grouped together from 2019/20. And FSCS's protection limit for investments, investment and pensions advice, home finance and debt management rises to £85,000 in respect of firm failures which occur on or after 1 April. We estimate this latter change will add roughly £20 million to compensation costs in 2019/20. The other changes affect the distribution of compensation costs, but not their size.

If aspects of funding regime are changing, the factors driving compensation costs are not. The final levy numbers we are publishing today do not differ markedly from the indicative numbers we set out in January. There has been a £16m increase since we published our indicative levy in January. So the 2019/20 levy will be £532m.

As in 2018/19, the main driver of the compensation costs falling on FSCS this year will continue to be pension claims. The bulk of these claims will continue to arise from bad advice to transfer retirement savings out of occupational schemes and into SIPPs – usually with a view to investment in risky and illiquid assets. But we have seen some falling off in the rate of growth of these claims which we now expect to number 8,200 in 2019/20 (7,800 last year) compared to our January forecast of 10,600. By contrast, we now expect more claims against the providers of SIPP platforms themselves next year. The result is a fall of £22 million in the levy on life, pensions and investment advisers, but a rise of £38 million in the levy on investment providers which include SIPP platform providers. The latter rise also reflects our expectation that we shall receive roughly 1,000 discretionary management claims arising from the failure of Beaufort Securities.

These trends underline the importance of the greater weight which FSCS intends to give in its strategy for the 2020s to both promoting awareness of FSCS protection and to preventing the mis-selling and advice failures which underlie these costs.

We shall need the support of our partners in the industry and in the FCA in both respects.

We know from our research that awareness of FSCS protection affects both consumers' propensity to save for retirement and choice of investment to generate a retirement income. We also know that consumers are more likely to seek regulated financial advice when they understand that FSCS protects them in the event of mis-selling. We would like to work with the industry on how best to communicate to consumers the key facts about our protection when they make potentially life-changing decisions about their pensions and retirement savings. This is the more important because around 15% of pensions claims result in losses which exceed our new protection limit of £85,000.

Equally, we want to work with the industry and the FCA on prevention. We gather much valuable insight and intelligence as a result of our work compensating consumers and pursuing recoveries. We believe that, in partnership, we can use this intelligence more systematically and purposefully to identify risks before they eventuate into major mis-selling episodes and to prevent advisers and directors involved in mis-selling re-inventing themselves.

Promotion and Prevention are the counterparts of our continuing and undiminished commitment to be prepared for failures when they occur and to provide an excellent service to consumers who need our protection as a result of failure.

ANNUAL LEVY 2019/20

The annual levy for 2019/20 is £532m - an increase of £16m from the indicative levy amount of £516m published in the January edition of our *Plan and Budget*. The final levy rates, after adjusting for provider contributions, are shown in the table below.

The main reasons for this increase are an uplift in the number of claims we now expect against SIPP operators and an upwards revision to the expected continuing costs in some historic insurances failures.

The SIPP operator forecasts will increase the levy on Investment Providers by £38m and claims on these insurance estates will increase the levy on the General Insurance Providers by £1m. These increases are partially offset by adjustments in other classes, most notably a decrease of £22m in the levy on Life, Pensions and Investment advisers caused by a levelling out of pension advice claims.

Table 1: 2019/20 Levies by funding class

Funding Class	Final Levy 2019/20 (£m)
Deposits	19
General Insurance Provision	166
Life Insurers	22
Home Finance Providers	1
General Insurance Distribution	12
Life Distribution, Pensions and Investment Intermediaries	153
Investment Provision	133
Home Finance Intermediaries	4
Debt Management	0
Base Costs	22
Total	**532**

SECTOR OVERVIEWS

Complete updates for each industry sector, including the variance from the figures published in our recent *Plan and Budget*, can be found in the tables on page 10. This section provides explanations for the sectors experiencing most movement in their annual levy levels.

Deposits

Two credit unions failed prior to the 2018/19 year-end and this left a deficit in the class which is being recouped. As such the levy is now set at £19m including provider contributions – an increase of £3m .

General Insurance Provision

The final levy has increased by £1m as a result of a £25m increase in the compensation forecast to March 2020. This mainly reflects revisions to the expected continuing claims costs in some of the historic estates. The main increases are in relation to BAI (£7m), Chester Street (£4m) and Gable (£3m) offset by a reduction in Enterprise (£6m). This is offset by a £24m surplus brought forward from the previous year.

Life, Pensions and Investment Advice

The levy required for Life, Pensions and Investment advice is reduced by £29m to £211m because of a reduction in the expected costs of compensation. Of this £58m is funded by provider contributions, leaving £153m to be paid by advisors themselves.

Our latest experience is that the pension claim volumes are flattening out. We have therefore reduced the pensions advice claims forecast from 10,600 to 8,200.

In addition, we have re-assessed the allocation of claims against Beaufort Securities based on negligent advice to invest in unsuitable stocks, following the review of some cases. We now think that around two thirds of these claims will most likely arise from discretionary fund management activity and so be Investment Provision claims. This reduces the cost on life, pension and investment advisors by £8m, with a commensurate transfer to Investment Providers.

Regarding the failure of London Capital & Finance (LCF), FSCS is working closely with Smith & Williamson, the Administrators, to understand more about how the firm carried out its regulated activities. Our current understanding is that the firm issued its own mini-bonds to investors on a non-advised basis and that these mini-bonds were not transferable securities. This activity is not a regulated activity under the Regulated Activities Order and, therefore, is not FSCS protected. For this reason, although the firm is insolvent, we are not accepting claims against the firm. Should we determine, however, that there are circumstances that give rise to potentially valid claims, we will begin to accept claims against LCF. At this stage it is too early to say which funding class is most likely to be levied if FSCS were to uphold claims against LCF.

Investment Provision

The levy for this sector has increased by £38m since the indicative levy driven by an increase in our estimate of the number of SIPP operator claims we expect to receive in the year.

As explained above we have also reassessed the funding sector for a number of the Beaufort Securities claims and now expect them to fall on this sector.

Insurance and Home Finance advisors

Although the final levies on these sectors are not materially different from the indicative levies there is one key assumption that is worth explaining. Mortgage Matters Partnership was declared to have failed (in default) in January and could generate up to 5,000 claims. From the information we have received so far, we expect approximately two-thirds of the claims to be PPI (General Insurance Distribution) and one-third mortgage advice (Home Finance Intermediation). ■

MANAGEMENT EXPENSES UPDATE

2019/20 approved budget

FSCS management expenses for 2019/20 are £74.6m, as set out in the *Plan and Budget*.

The PRA and FCA have set the FSCS Management Expenses Levy Limit (MELL) at £79.6m, which allows for an unlevied reserve contingency of £5m. The policy statement was published on 29 March 2019 and is available here.

This budget is flat in real terms and represents an increase of £1.9m (2.4%), compared to the 2018/19 management expenses budget. The main factors bearing on the budget are:

Outsourced claims handling – decrease of £2.6m:

- Despite increasing SIPP and pensions claim volumes (£3.9m in associated cost), efficiency savings generated by our partnership with a sole outsourcer partner are expected to yield £6.5m of reduced claims processing costs

Internal claims handling support costs:

- A reduction of £1.2m in Independent Insurance income as the insolvency estate's contribution has been exhausted, therefore our net cost base is increasing compared to 2018/19

Core Support – a £2.6m increase:

- We will invest in business-critical skills, including a small increase in headcount, strengthening FSCS operations and ensuring preparedness when responding to claims
- This will include investment in payments, finance and sanctions processes and investment in IT, in particular cyber-security.
- Investment to support early work on our Prevent strategic pillar

Provisions for the UK's exit from the EU, uncrystallised failures and VAT (increase of £0.6m):

- This includes a contingent provision for a range of eventualities, including uncrystallised firm failures, a potential VAT liability on insurance claims handling and the UK's exit from the EU.

2018/19 Update

Our latest forecast for management expenses for 2018/19 was £74.2m against a budget of £72.7m. This reflected increased outsourced claims processing costs mainly because of higher than expected Life & Pension advice volumes.

Consequently, we expected to need to access up to £1.5m of unlevied contingency reserve included within the MELL set by the PRA and FCA. We notified the PRA and FCA accordingly. In the event we incurred an additional £1.46m.

The management expenses budget can be found on page 13.

NEW COMPENSATION LIMITS AND FUNDING REVIEW

FSCS's limit has been raised to £85,000 for more of the financial activities and products it covers. This follows an FCA consultation on FSCS's funding arrangements.

As well as protecting deposits up to £85,000 in banks, building societies and credit unions, these new limits apply:

- Investment provision is now £85,000 per person per firm, up from £50,000.
- Investment intermediation is now £85,000 per person per firm, up from £50,000.
- Life and pensions intermediation is now £85,000 per person per firm, up from £50,000.
- Home finance intermediation is now £85,000 per person per firm, up from £50,000.
- Debt management is now £85,000 per person per firm, up from £50,000.
- Long-term care insurance is now 100% of the claim per person per firm, up from £50,000.

Customers of firms that have failed and were declared in default before 1 April 2019 will be covered up to the previous £50,000 limits. The new limits apply to claims against firms that fail on or after 1 April 2019.

Levy class limits

Following consultation, the FCA set a limit on the amount that can be levied on each industry sector in a year, by reference to what each class can be expected to afford in a year. The limits are set out in the FCA Handbook and the PRA Rulebook, in both cases at FEES 6 Annex 2.

For the levy year 2019/20, the limits are:

PRA classes

- Deposits: £1,500m
- Life and pensions provision: £690m
- General insurance provision: £600m

FCA classes

- General Insurance Distribution: £410m (including provider contribution of £100m)*
- Investment Intermediation: £330m (including provider contribution of £90m)*
- Home Finance Intermediation: £55m (including provider contribution of £15m)*
- Investment Provision: £200m
- Debt management: £20m
- Deposit acceptors: £105m (only if the retail pool is triggered)

* Since 1 April 2019, product providers are required to contribute approx. 25% of the levies falling to the FCA intermediation classes, from the first pound.

Retail pool

If the levies on a sector exceed the limit for that sector, the excess is levied more widely on the other industry sectors as part of what is known as "the retail pool". All industry sectors benefit from and contribute to the retail pool (with the exception of deposit acceptors and insurance providers, which only contribute to the retail pool).

CASE STUDY: RECOVERIES WORK

FSCS has a statutory duty, in certain circumstances, to pursue recoveries in accordance with its rules, in order to offset against future levies or refund the industry. These funds can also sometimes be used to pay further monies to customers with uncompensated losses.

FSCS has recovered just under £300 million[1] over the past five years from failed financial services firms. These sums reduced FSCS levies on the industry.

In addition, FSCS recovered billions of pounds following the resolutions of the 2008 banking failures, where FSCS needed to take out loans totalling approximately £20 billion from the Government at the time of the financial crisis. Those loans have now been repaid in full, largely through FSCS's recoveries work.

In order to reduce the costs of compensation for its levy payers, FSCS seeks to recover amounts paid in compensation from any party that it considers has a legal responsibility. As part of the process of paying compensation, the legal rights of our customers are transferred to FSCS. FSCS then "stands in the shoes" of its customers in pursuing any recovery action.

A recovery action is a legal claim which FSCS pursues in order to recover the compensation it has paid to customers, whether through a formal insolvency process, through litigation or some form of dispute resolution. In pursuing recoveries, FSCS must apply what is in essence a commercial test – is the recovery worth pursuing, and is the defendant good for the money? It doesn't pursue recoveries just to make a point or to punish the parties in question.

In taking recoveries action, FSCS increasingly deals with a number of other Government agencies, such as the Financial Conduct Authority (FCA), the Serious Fraud Office (SFO) and the Insolvency Service. FSCS also deals very regularly with a wide range of insolvency practitioners (IPs).

The usual avenues of recovery we pursue include actions against failed firms and their Professional Indemnity insurers. Increasingly, however, we are taking ever more complex recoveries action and in those instances we tend to make use of our panel of law firms, who have both the expertise and jurisdictional reach to assist us.

In addition to the more usual avenues of recovery, FSCS has been involved in some high-profile, high-value and complex recoveries work in recent times:

- Keydata litigation: court proceedings against a large number of IFA firms in relation to their mis-selling of Lifemark investments – a large and complex piece of litigation against hundreds of IFAs, resulting in recoveries of over £128 million.
- PPI litigation: court proceedings against a number of lenders for undisclosed and excessive commissions as part of PPI arrangements, resulting in recoveries of just under £20 million.
- Harlequin: a collection of companies involved in the marketing, sales and development of overseas investment properties. FSCS is currently pursuing recoveries against various Harlequin entities, largely through the insolvencies which are already on foot in the UK and the Caribbean.

Recoveries will play an essential role in our new strategy for the 2020s. ■

1 From FY 2014/15 to FY 2018/19 year to date to 31 Jan 2019. This figure is gross i.e. before any amounts repaid to customers with claims over FSCS's compensation limits. Calculating recoveries income can involve complex accounting and figures can differ according to which methodology is used. Nonetheless, in any given year FSCS saves the financial services industry millions of pounds through recoveries.

STRATEGY UPDATE

2019/20 is the first year of our new strategy, *FSCS into the 2020s: Protecting the Future*. The strategy has four pillars: Prepare, Protect, Promote and Prevent.

> "FSCS must be prepared to protect consumers when major failures occur if we are to play our part in underpinning financial confidence and stability."

First, FSCS must be prepared to protect consumers when major failures occur if we are to play our part in underpinning financial confidence and stability. Second, we must protect those who come to us by providing an outstanding service to our customers day-to-day. Third, we must promote awareness of FSCS's service among consumers across all protected products so that people know how, and to what limits, they are protected if the worst happens and can make informed choices about financial products. Finally, we must share what we learn about the causes and consequences of failure with government and regulators and so contribute to improving regulation and preventing future failure.

Since publishing our *Plan and Budget* we have formed joint pillar leads who will be accountable for the delivery of activities under each strategic pillar. These leads are implementing agreed work plans for the first quarter of this year and have established initial key performance indicators and indicators of success which will be reported to the Board.

We will update the industry and our stakeholders on our progress and development of KPIs in the next edition of *Outlook*. ■

Latest Position by Funding Class

Funding class	Final Levy Latest (£m)	Plan and Budget (£m)	Variance to Plan and Budget (£m)
Deposits	19	16	3
General Insurance Provision	166	165	1
Life insurers	22	25	(3)
Home Finance Providers	1	1	0
General Insurance Distribution	12	13	(1)
Life Distribution, Pensions & Investment Intermediaries	153	175	(22)
Investment Provision	133	95	38
Home Finance Intermediaries	4	4	0
Debt Management	0	0	0
Base costs	22	22	0
Total	**532**	**516**	**16**

Deposits

2019/20 Forecast (12mths) (£m)	Final Levy Latest (£m)	Plan and Budget (£m)	Variance to Plan and Budget (£m)
Opening balance	(2.33)	0.34	(2.67)
Compensation	(5.38)	(5.38)	0.00
Recoveries	6.00	6.46	(0.46)
Management Expenses	(12.62)	(12.62)	0.00
Annual levy receipts	16.00	12.00	4.00
Forecast Closing Balance 30/6/20	1.67	0.80	0.87
Retail Pool Levy Contribution	0.00	0.00	0.00
Closing Balance	**1.67**	**0.80**	**0.87**

General Insurance Provision

2019/20 Forecast (12mths) (£m)	Final Levy Latest (£m)	Plan and Budget (£m)	Variance to Plan and Budget (£m)
Opening balance	24.53	0.34	24.19
Compensation	(179.22)	(154.28)	(24.94)
Recoveries	1.20	1.20	0.00
Management Expenses	(7.43)	(7.43)	0.00
Annual levy receipts	162.00	161.00	1.00
Forecast Closing Balance 31/3/20	1.08	0.83	0.25
Retail Pool Levy Contribution	0.00	0.00	0.00
Closing Balance	**1.08**	**0.83**	**0.25**

Life and Pension Provision

2019/20 Forecast (12mths) (£m)	Final Levy Latest (£m)	Plan and Budget (£m)	Variance to Plan and Budget (£m)
Opening balance	0.18	0.00	0.18
Compensation	0.00	0.00	0.00
Recoveries	0.00	0.00	0.00
Management Expenses	0.00	0.00	0.00
Annual levy receipts	6.61	0.00	6.61
Interim Levy/refunds	(6.61)	0.00	(6.61)
Forecast Closing Balance 31/3/20	0.18	0.00	0.18
Retail Pool Levy Contribution	0.00	0.00	0.00
Closing Balance	**0.18**	**0.00**	**0.18**

General Insurance Intermediation

2019/20 Forecast (12mths) (£m)	Final Levy Latest (£m)	Plan and Budget (£m)	Variance to Plan and Budget (£m)
Opening balance	3.65	0.61	3.04
Compensation	(10.60)	(8.60)	(2.00)
Recoveries	0.00	0.00	0.00
Management Expenses	(7.96)	(7.96)	0.00
Annual levy receipts	16.00	17.00	(1.00)
Forecast Closing Balance 31/3/20	1.09	1.05	0.04
Retail Pool Levy Contribution	0.00	0.00	0.00
Closing Balance	**1.09**	**1.05**	**0.04**

Life Distribution, Pensions & Investment Intermediation

2019/20 Forecast (12mths) (£m)	Final Levy Latest (£m)	Plan and Budget (£m)	Variance to Plan and Budget (£m)
Opening balance	(10.28)	1.94	(12.22)
Compensation	(193.32)	(236.91)	43.59
Recoveries	10.41	13.41	(3.00)
Management Expenses	(17.35)	(17.35)	0.00
Annual levy receipts	211.00	240.00	(29.00)
Forecast Closing Balance 31/3/20	0.46	1.09	(0.63)
Retail Pool Levy Contribution		0.00	0.00
Closing Balance	**0.46**	**1.09**	**(0.63)**

Investment Provision

2019/20 Forecast (12mths) (£m)	Final Levy Latest (£m)	Plan and Budget (£m)	Variance to Plan and Budget (£m)
Opening balance	15.10	7.46	7.64
Compensation	(113.97)	(64.42)	(49.55)
Recoveries	0.00	0.00	0.00
Management Expenses	(0.60)	(0.60)	0.00
Annual levy receipts	101.00	59.00	42.00
Forecast Closing Balance 31/3/20	1.53	1.44	0.09
Retail Pool Levy Contribution		0.00	0.00
Closing Balance	**1.53**	**1.44**	**0.09**

Home Finance Intermediation

2019/20 Forecast (12mths) (£m)	Final Levy Latest (£m)	Plan and Budget (£m)	Variance to Plan and Budget (£m)
Opening balance	8.83	7.41	1.42
Compensation	(12.05)	(9.72)	(2.34)
Recoveries	0.00	0.00	0.00
Management Expenses	(1.58)	(1.58)	0.00
Annual levy receipts	5.00	5.00	0.00
Forecast Closing Balance 31/3/20	0.20	1.11	(0.91)
Retail Pool Levy Contribution		0.00	0.00
Closing Balance	**0.20**	**1.11**	**(0.91)**

MANAGEMENT EXPENSES

Management expenses	Budget 2018/19 (£m)	Forecast 2018/19 (£m)	Budget 2019/20 (£m)
Claims handling infrastructure and support	**50.9**	**54.0**	**53.1**
Outsourced claims handling	16.0	17.8	13.4
Internal claims handling support	7.6	7.9	9.5
Core Support - IT, facilities and central services	25.5	23.8	28.1
Investment: systems maintenance and improvement	0.0	4.5	0.0
Provisions for VAT, uncrystallised failures and UK's exit from the EU	1.8	0.0	2.1
Bank charges	**7.6**	**6.8**	**7.6**
Depositor protection, investment, recoveries and pension deficit	**14.2**	**13.4**	**13.9**
Depositor protection	3.9	4.4	3.1
Consumer protection	0.0	0.0	1.2
Recoveries	3.9	3.6	3.7
Investment: digital and outsourcing	4.0	3.5	4.0
Pension deficit funding	2.4	1.9	1.9
Total management expenses	**72.7**	**74.2**	**74.6**

CAROLINE RAINBIRD TO BE NEW FSCS CEO, SUCCEEDING MARK NEALE

Outgoing CEO Mark Neale's last day will be 3 May 2019 and Caroline's appointment takes effect from 4 May 2019 for a period of three years. She also joins the Board of FSCS.

The appointment has been made by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), who had representatives on the recruitment panel, and approved by HM Treasury.

Prior to joining the FSCS Caroline was Managing Director of Regulatory Affairs (2015–2017) at RBS Plc where she was responsible for defining and delivering the bank's strategic and proactive engagement and profile with its global regulators, advising the Bank Board and Executive on its regulatory engagement and compliance, as well as monitoring bank-wide upstream regulatory risks and delivering mandatory regulatory change programmes.

Between 2009–2015 she was Director, Corporate Services Division, also at RBS Plc, where she was responsible for the global strategy, operations, service delivery, financial performance and risks of one of the largest cost areas within RBS with c. 2,000 employees across 40 countries and a direct cost budget of £2bn. Her portfolio of responsibilities included Property, Procurement, Security, Business Resilience, Environmental policy and Health and Safety.

Whilst at RBS Caroline was a member of their Sustainable Banking Committee, which had a specific strategic focus on culture, customer, people, brand and ESE areas and was selected to be an active member of the Boards of the Chartered Banker: Professional Standards Board and the BBA.

Between 1995 and 2009 she worked at ABN AMRO as Head of EMEA Structured and Project Finance Group (1995–2001), Executive Director, Business Manager to ABN AMRO Group CAO and CFO (2001–2003), and Executive Director Head of Investment Banking Change (2003–2004). Her final role at ABN AMRO was as Chief Financial Officer, Group Shared Services Division (2004–2009) where she was responsible for the effective and proactive management of the Shared Services' global cost base.

She started her career with roles at HSBC and the Long-Term Credit Bank of Japan. Caroline holds a BA (Joint Hons.) in History and Economic & Social History from the University of Kent at Canterbury.

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