News from the Financial Services Compensation Scheme

outlook

April 2018

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CHIEF EXECUTIVE'S STATEMENT

Mark Neale, Chief Executive

> Risks rise as people make increasingly complex choices about the investment of their pension pots.

The main purpose of this Spring edition of *Outlook* is to brief stakeholders on FSCS's levies for 2018/19. This updates the levy forecasts we included in our *Plan & Budget 2018/19*, published in January.

To remind you, our levies for 2018/19 cover the nine months from 1 July 2018 to 31 March 2019 as we align our levy year with the financial year. Because our levies cover only a nine-month period, we have also, where relevant, pro-rated the annual levy limits commensurately.

These updated levy numbers do include some significant increases. Overall, we now forecast aggregate compensation costs in 2018/19 of £330m, compared to a January forecast of £286m. To fund these costs and our management expenses, we are now raising levies of £407m, compared to our forecast of £336m.

The significant changes are an increase of £52m in the Life & Pensions Intermediation levy. The Investment Intermediation levy has decreased by £4m for 2018/19, while home finance claims from the default of Fuel Investments pushed up the levy for this class by £5m.

Stepping back from these numbers, I once again draw attention to the steady increase in claims and compensation costs related to retirement saving. Risks rise as people make increasingly complex choices about the investment of their pension pots, even where investors take the sensible step of taking independent professional advice.

Regular readers of our publications will know that, in recent years, these costs have largely related to bad advice to transfer pension savings from occupational schemes into Self-Invested Personal Pensions (SIPPs), usually with a view to invest in illiquid and risky unregulated assets.

This year our forecasts also allow for new sources of pension claims.

As we announced in January, FSCS has declared in default three SIPP operators (Stadia Trustees Limited, Brooklands Trustees Limited and Montpellier Pension Administration Limited.) After careful consideration, this reflected our judgment that these firms owed liabilities to a number of claimants because of due diligence failings. We now expect the compensation costs arising from these claims to total £34m, compared to our January forecast of £32m for the nine-month year of 2018/19. These costs will fall on investment providers.

Since the publication of our *Plan & Budget 2018/19*, we have also seen the failure of Active Wealth, which advised members of the British Steel Pension Scheme, amongst others, to realise the value of their defined benefit pension benefits in order to transfer the funds into SIPPs. We cannot rule out that we shall see further claims of this kind. We forecast the cost of Active Wealth and other firms who advised British Steel workers in 2018/19 as £10m, which will fall on life and pensions advisers.

As with last year, we expect that compensation costs falling to this class in 2018/19 will exceed the pro-rated annual limit and result in a call on other industry sectors in the retail pool.

This trend towards greater complexity in the claims coming to FSCS, reflecting the demanding choices facing consumers, forms an important part of our thinking about FSCS's strategy for the 2020s. That strategy, which we are now developing, will need to address consumers' requirements for better understanding of FSCS's protection, as well as for a service, which, when called on, is fast, easy to use and empathetic. The industry wants FSCS to deliver protection and support consumer confidence, but as efficiently as possible, with costs offset by maximising recoveries. The authorities need to be sure that FSCS can deliver protection when called upon, even (or especially) at times of stress. It is important that consumers and all stakeholders know about and have trust in FSCS. We shall be engaging with our stakeholders in taking this work forward. We aim to publish our strategy in the early Autumn. ■

Funding class	**Final Levy 2018/19 (£m)**
Deposits (SA01)	19
General Insurance Provision (SB01)	89
General Insurance Intermediation (SB02)	16
Life & Pensions Provision (SC01)	0
Life & Pensions Intermediation (SC02)	75
SC02 funded by Retail Pool	*64*
Investment Provision (SD01)	52
Investment Intermediation (SD02)	42
Home Finance Intermediation (SE02)	22
Debt Management (SK01)	0
Base costs	**28**
TOTAL	**407**

Key components of 2018/19 Annual Levy

FSCS has increased the final levy by £71m from the indicative forecast, to £407m, as shown above. In addition, the levy relating to the 2008/09 bank failures will be £46m.

The main reason for the increase in the final levy is the rise in defined benefit pension transfer claims. £10m of the increase is accounted for by Active Wealth and other firms that advised British Steel workers. Although we are yet to see claims volumes, or values, we do think it appropriate to make a substantial allowance for these firms. The total deficit forecast in the Life & Pensions intermediary class is £64m, which will be levied on the Retail Pool.

The levy proposed is for the nine months to 31 March 2019, as we align our levy years for all classes except for the deposit class, which continues to be calculated on a July to June basis. ■

SECTOR OVERVIEW

Compensation costs and reasons for main changes, by sector

We have projected total compensation costs forward to 31 March 2019 to reflect the fact that each year from now on, our annual levy will be in line with the financial year, from April to March.

Compensation costs, however, arising in the first quarter of the 2018/19 financial year are covered by the annual levies raised in 2017/18.

By the end of the first quarter of 2018/19, we expect our funds balance will have fallen to (£3m) - £25m lower than we forecast in January. This is because our compensation forecast for 2017/18 has increased by £31m to £432m, offset by higher than expected recoveries of £14m. This negative balance of £3m is the starting point for calculating levies for 2018/19.

As always, we do not levy for compensation costs unless there is a reasonable expectation that we will have to meet the costs of claims in a particular sector.

We explain below how we have arrived at our levy calculation for each industry sector or funding class. Our assumptions about compensation costs levies for the year ahead have been calculated using both our 36-month funding approach and the 12-month forecast.

Firms will receive their annual levy bills from June 2018 (payable within 30 days). Commercial financing arrangements may be available to firms that require them. From 2019/20, on-account fee payers will pay some FSCS levy on account too: in April, with the remainder due in September.

Life & Pensions Intermediation

When the indicative Life & Pensions Intermediation levy was calculated in December, we expected that the retail pool would have to contribute £12m towards costs for the nine-month period to March 2019. Since then, we have increased the compensation forecast, for 2017/18 and 2018/19, by £52m, because of increases in the volume and value of defined benefit pension transfer claims. The forecast for SIPP-related claims has fallen by £2m in that time, so the increase is wholly a result of transfer claims.

Included in the overall £52m increase is an early estimate of £10m to cover payments against Active Wealth and other firms that advised British Steel workers. This IFA gave advice in relation to, amongst others, British Steel workers to transfer pensions.

FSCS has also continued to receive significant numbers of claims against independent financial advisers in relation to advice given to customers to transfer existing pension arrangements into SIPPs. The vast majority of these claims relate to advice to invest pension monies into high risk, non-standard asset classes within the SIPP wrapper.

Because of their risky nature, many of these investments become illiquid and also insolvent. These investments were unsuitable for the majority of investors, which also means we are more likely to uphold these claims. Over the past year, FSCS has paid compensation of £112m for SIPP-related claims, compared with £96m in the previous year – an increase of 17%.

The result of these two adjustments to the forecast is that the total 2018/19 levy required for the class has risen from £87m to £139m for the period to 31 March 2019. As the pro-rated levy limit on the class is now £75m, we expect £64m of the total will need to be funded by the retail pool, an increase of £52m from the £12m estimate mentioned above, which we published in the *Plan & Budget*.

As in the last two years, we have decided that the most appropriate course of action is to raise the maximum £75m levy on Life & Pensions Intermediary firms initially, and not raise the additional retail pool levy as part of this invoicing run. Firms in the retail pool can start planning for their contribution later in the year. We will then monitor the anticipated funding requirements and only levy what is needed when we have greater certainty.

Investment Provision

Due diligence failings at three SIPP operators declared in default: Stadia Trustees Limited, Brooklands Trustees Limited and Montpellier Pension Administration Limited, have resulted in a rise in the forecast for compensation costs for this class from £32m in January to £34m.

Investment Intermediation

The levy will be decreased by £4m to £42m because of an increase in forecast recoveries for the remainder of 2017/18.

Beaufort Securities, the broker, and Beaufort Asset Clearing Services, its corporate client division, were declared in default by FSCS in March this year. The FSCS aims to compensate around 22,500 customers from May 2018.

Strand Capital Limited, a discretionary fund manager with around 3,000 clients, entered default in May 2017. The FSCS is working closely with the joint special administrators to return cash and assets to Strand customers.

We have chosen to use the three-year historical average to calculate the final levy. This results in an amount of £14m for unexpected claims. Historically, this class has been the most volatile in terms of costs, mainly because of the number of product categories and firms. As there is uncertainty around the claims mentioned above, this reserve would be used if required.

General Insurance Provision

The final levy has not changed materially from the indicative levy at £89m. As we set out in January, this is based on claims against firms that we are already receiving.

Home Finance Intermediation

Claims continue to be received for this class against Fuel Investments. Contrary to previous expectations, there are indications of a greater number of claims, which, along with higher uphold rates and the expensive nature of the claims, has meant that the forecast for new claims for this class has risen by £5m to 31 March 2019.

2008/9 Bank Failure Costs Levy

At the start of the year, FSCS had liabilities to HM Treasury arising from the resolutions of Bradford & Bingley and Dunfermline Building Society.

We continue to receive dividends from some legacy failures where we have repaid our borrowings from HM Treasury. We received dividends of £31m from Kaupthing Singer & Friedlander during the year.

For Bradford & Bingley, FSCS has previously reported that our loan balance with HM Treasury reduced to £4.7bn on 25 April 2017, following sales of mortgage assets by Bradford & Bingley. The interest due for the year to 31 March 2018, payable in arrears, has now been calculated at £99m.

UK Asset Resolution has announced that it has launched a further asset sales programme, designed to repay the FSCS loan with HM Treasury in full. As and when the loan is repaid in full, no further interest will accrue (although a balance for the period into 2018/19 will be due). On the assumption that the loan is repaid from such proceeds early in 2018/19, FSCS will seek to pay that amount for the "rump" period in 2018/19, even though it would not fall due before October 2019.

On Dunfermline, we have agreed and settled with HM Treasury a final payment as FSCS's contribution to the costs of its resolution in 2009. FSCS had paid £500m towards such costs and settled the final payment of £21m in March this year.

As a result of cash already to hand and recoveries made on other estates, FSCS will only need to levy £46m in the summer of 2018 to meet these costs. Payment to HM Treasury of the accrued interest on the B&B loan would then bring FSCS's liability to HM Treasury incurred during the crisis to a close.

MANAGEMENT EXPENSES UPDATE

FSCS management expenses for 2018/19 are £72.7m, as set out in the *Plan & Budget*.

The overall budget represents an increase of £3.5m on the 2017/18 budget, driven mainly by the following:

- IT, facilities and central services - £2.7m increase to renew IT equipment and to fund Brexit-related activity, strengthening the FSCS risk function and implementing outcomes from the FCA review of FSCS funding;
- Bank charges - £1.7m increase to enable FSCS to borrow up to £1.45bn, primarily to provide liquidity for any new and larger deposit sector failures, enabling FSCS to compensate customers within seven days; and
- Pension deficit funding - £0.5m increase to allow for potentially increased contributions to fund the deficit in FSCS's (closed) defined benefit pension scheme, following the triennial actuarial review that began recently.

The allocation of expenses to classes is also unchanged since the Indicative Levy was published. In March 2018, the PRA and FCA set the FSCS Management Expenses Levy Limit (MELL) at £77.7m, including an unlevied contingency reserve.

The base costs are levied by reference to the FCA and PRA fee blocks. The funding rules state that FSCS's base costs are first spilt equally between PRA and FCA firms. The 50% share that will be allocated to PRA firms will then be allocated to the individual PRA fee blocks by reference to the share of each fee block of the total PRA fees for that year. Likewise, the same allocation will be made for the 50% share of base costs allocated to FCA firms.

The management expenses budget (and latest forecast) is shown in Appendix 2, the split of management expenses is in Appendix 3 and the base costs are provided in Appendix 4

OXERA RESEARCH

In 2017, FSCS commissioned Oxera, an economics consultancy and the Centre for Experimental Social Science (CESS), to conduct a large-scale behavioural experiment to examine how protection scheme awareness might affect how savers choose to fund their retirement.

The experiment showed that people's appetite for risk – and choice of retirement product – could change, when they know or hear about FSCS.

It showed that people who are aware of FSCS are less inclined to buy riskier products and more inclined to opt for those the Scheme protects. People who are aware of FSCS or think FSCS is important are also more likely to take advice and less likely to question the price of that advice, the study found.

To bring together the Oxera findings, separate mystery shopping findings, which showed a gap in the quality of information that firms are providing to their customers, and consumer research amongst those who have used their pension savings to buy a retirement product, FSCS published a report in March: *The need to know: FSCS protection makes a difference*.

The research underscores the importance of advisers helping retirees make decisions that have life-long consequences. It also shows that advisers can do much more to promote awareness of FSCS, as a key source of information for retirees.

LATEST POSITION

Appendix 1:

Final levy figures (by funding class)

Class	Final Levy 2018/19 (£m)	Indicative Levy 2018/19 (£m)	Variance (£m)
Deposits (SA01)	**19**	16	3
General Insurance Provision (SB01)	**89**	88	1
General Insurance Intermediation (SB02)	**16**	23	(7)
Life and Pensions Provision (SC01)	**0**	0	0
Life and Pensions Intermediation (SC02)	**75**	75	0
Funded by Retail Pool	***64***	*12*	*52*
Investment Provision (SD01)	**52**	34	18
Investment Intermediation (SD02)	**42**	46	(4)
Home Finance Intermediation (SE02)	**22**	17	5
Debt Management (SK01)	**0**	0	0
Base costs	**28**	25	3
Total	**407**	**336**	**71**

Class tables

Deposits

Deposits (SA01)	Final Levy 2018/19 (£m)	Indicative Levy 2018/19 (£m)	Variance (£m)
Opening balance	**(0.03)**	2.51	(2.54)
Compensation	**(4.20)**	(4.20)	0.00
Recoveries	**0.00**	0.00	0.00
Management expenses	**(13.98)**	(13.98)	0.00
Annual Levy receipts	**19.00**	16.00	3.00
Interim Levy/refunds	**0.00**	0.00	0.00
Forecast closing balance 30/6/19	**0.79**	**0.33**	**0.46**

General Insurance Provision

General Insurance Provision (SB01)	Final Levy 2018/19 (£m)	Indicative Levy 2018/19 (£m)	Variance (£m)
Opening balance	**14.64**	8.22	6.42
Compensation	**(96.67)**	(89.67)	(7.00)
Recoveries	**1.00**	1.00	0.00
Management expenses	**(6.85)**	(6.85)	0.00
Annual Levy receipts	**89.00**	88.00	1.00
Interim Levy/refunds	**0.00**	0.00	0.00
Forecast closing balance 31/3/19	**1.11**	**0.70**	**0.42**

General Insurance Intermediation

General Insurance Intermediation (SB02)	Final Levy 2018/19 (£m)	Indicative Levy 2018/19 (£m)	Variance (£m)
Opening balance	**4.77**	(0.24)	5.01
Compensation	**(11.78)**	(14.35)	2.56
Recoveries	**0.00**	0.00	0.00
Management expenses	**(7.88)**	(7.88)	0.00
Annual Levy receipts	**16.00**	23.00	(7.00)
Interim Levy/refunds	**0.00**	0.00	0.00
Forecast closing balance 31/3/19	**1.11**	**0.53**	**0.57**

Life & Pension Intermediation

Life and Pensions Intermediation (SC02)	Final Levy 2018/19 (£m)	Indicative Levy 2018/19 (£m)	Variance (£m)
Opening balance	**(20.38)**	0.12	(20.50)
Compensation	**(108.67)**	(76.81)	(31.85)
Recoveries	**0.00**	0.00	0.00
Management expenses	**(9.22)**	(9.22)	0.00
Annual Levy receipts	**139.00**	87.00	52.00
Interim Levy/refunds	**0.00**	0.00	0.00
Forecast closing balance 31/3/19	**0.73**	**1.08**	**(0.36)**

Investment Provision

Investment Provision (SD01)	Final Levy 2018/19 (£m)	Indicative Levy 2018/19 (£m)	Variance (£m)
Opening balance	**(17.73)**	(2.33)	(15.40)
Compensation	**(34.62)**	(31.50)	(3.12)
Recoveries	**0.00**	0.00	0.00
Management expenses	**0.00**	0.00	0.00
Annual Levy receipts	**52.00**	34.00	18.00
Interim Levy/refunds	**0.00**	0.00	0.00
Forecast closing balance 31/3/19	**(0.35)**	**0.17**	**(0.52)**

Investment Intermediation

Investment Intermediation (SD02)	Final Levy 2018/19 (£m)	Indicative Levy 2018/19 (£m)	Variance (£m)
Opening balance	**22.91**	17.76	5.15
Compensation	**(58.99)**	(57.96)	(1.04)
Recoveries	**2.81**	2.81	0.00
Management expenses	**(7.86)**	(7.86)	0.00
Annual Levy receipts	**42.00**	46.00	(4.00)
Interim Levy/refunds	**0.00**	0.00	0.00
Forecast closing balance 31/3/19	**0.87**	**0.75**	**0.12**

Home Finance Intermediation

Home Finance Intermediation (SE02)	Final Levy 2018/19 (£m)	Indicative Levy 2018/19 (£m)	Variance (£m)
Opening balance	**(5.80)**	(4.69)	(1.10)
Compensation	**(14.73)**	(11.07)	(3.66)
Recoveries	**0.00**	0.00	0.00
Management expenses	**(1.19)**	(1.19)	0.00
Annual Levy receipts	**22.00**	17.00	5.00
Interim Levy/refunds	**0.00**	0.00	0.00
Forecast closing balance 31/3/19	**0.28**	**0.05**	**0.24**

Appendix 2: Final management expenses budget for 2018/19

Management expenses budget – by activity

Management Expenses	Forecast 2017/18 (£m)	Budget 2017/18 (£m)	Budget 2018/19 (£m)
Claims handling infrastructure and support	**51.2**	**50.2**	**51.0**
Outsourced claims handling	16.6	16.2	16.2
Internal claims handling support	6.7	7.4	7.5
IT, facilities and central services	21.4	20.1	22.8
Investment: systems maintenance and improvement	6.5	6.5	4.5
Bank charges	**5.9**	**5.9**	**7.6**
Depositor protection, investment, recoveries and pension deficit	**12.2**	**13.1**	**14.1**
Depositor protection	4.1	4.7	4.3
Recoveries	3.7	4.0	3.9
Investment: digital and outsourcing	2.3	2.5	3.5
Pension deficit funding	1.9	1.9	2.4
Total management expenses	**69.2**	**69.2**	**72.7**

Appendix 3:

Split of management expenses budget for 2018/19

	FSCS Management Expenses 2018/19 (£m)	PRA Fee Block Allocation 2018/19 (£m)	FCA Fee Block Allocation 2018/19 (£m)
Base Costs Total (Split 50:50)	**25.7**	**12.8**	**12.8**
Specific Costs			
Deposits (SA01)	14.0	14.0	0.0
General Insurance Provision (SB01)	6.9	6.9	0.0
General Insurance Intermediation (SB02)	7.8	0.0	7.8
Life & Pension Provision (SC01)	0.0	0.0	0.0
Life & Pension Intermediation (SC02)	9.2	0.0	9.2
Investment Provision (SD01)	0.0	0.0	0.0
Investment Intermediation (SD02)	7.9	0.0	7.9
Home Finance Intermediation (SE02)	1.2	0.0	1.2
Specific Costs Total	**47.0**	**20.9**	**26.1**
Management Expenses Total	**72.7**	**33.7**	**39.0**

Appendix 4:
Final base costs levy 2018/19

FCA	PRA	Fee block	FCA (£m)	PRA (£m)
AP00		FCA Prudential Fee	0.46	n/a
A000	PA00	Zero Fee Block	0.55	0.04
A001	PA01	Deposits	2.01	8.80
A002		Home Finance Providers	0.49	n/a
A003	PA03	General Insurance	0.72	1.88
A004	PA04	Life Insurance	1.24	2.50
A005	PA05	Managing Agents at Lloyds	n/a	n/a
A006	PA06	Society of Lloyds	0.01	0.10
A007		Fund Managers Holding	1.28	n/a
A009		Unit Trust Managers	0.35	n/a
A010	PA10	Dealing as Principal	1.53	0.69
A013		Brokers Not Holding	2.07	n/a
A014		Corporate Finance	0.40	n/a
A018		Mortgage Brokers	0.47	n/a
A019		Insurance Intermediaries	0.77	n/a
A021		Firms holding client money or assets or both	0.40	n/a
CC1		Consumer credit – limited permission	0.20	n/a
CC2		Consumer credit – full permission	1.06	n/a
		Total:	**14.00**	**14.00**

NEW CHAIRMAN

Marshall Bailey, Chairman appointed April 1 2018

We are delighted to welcome Marshall Bailey to the Scheme.

Marshall has substantial experience of leading complex international committees and boards. His background spans a range of sectors, including banking and capital markets, government regulation, and public policy. Marshall has had an active role in Fixed Income, Currencies and Commodities Markets (FICC) on working with codes of conduct, and was a member and Co-Chair of the Market Participants Group of the BIS Global FX Code team.

Marshall is also the non-executive Chairman of CIBC World Markets Plc in London, and a member of the Audit committee for the London branch. Additionally, he is a non-executive Director and Chair of the Risk Committee of Chubb European Group Insurance Ltd, giving him substantial investment banking and leadership experience at an international level, and has recently been appointed as a Representative for the Public Investment Fund in Saudi Arabia on the board of the National Commercial Bank in Jeddah.

He has been an Independent Director on the board of UK Financial Investments Ltd (UKFI), the government body overseeing the UK Government's ownership of RBS and UK Asset Resolution from the era of the financial crisis. He volunteers on the Board of the CFA Society of the UK, as well as the East End Community Foundation in Tower Hamlets, where he lives.

Marshall holds a BA in Political Science from the University of Winnipeg, a Master of Arts in International Affairs and History from the Graduate Institute of International and Development Studies in Geneva, Switzerland and is a Chartered Financial Analyst. He has also completed the FT Non-Executive Directors' Diploma.

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