FSCS Podcast – Episode 27 Mini-pod: What happens behind the scenes before we declare a firm 'in default'?

Jess Spiers 00:01

Welcome to Protect your money with FSCS, the podcast from the Financial Services Compensation Scheme. Today we've got a mini pod for you, a special bitesize episode where we talk through a particular topic to explain it all simply. In this series, we explain how we can help to protect your money so you can feel confident your money is safe. Let's get into the conversation now.

Nigel Yeates 00:26

Welcome to this short episode of the FSCS podcast. I'm your host Nigel Yeates, Communications and Stakeholder Business Partner at FSCS. I'm joined today by my colleague Simon Wilson. Simon, could you please introduce yourself?

Simon Wilson 00:38

Thanks Nigel. Hi, everyone, I'm Simon Wilson and I'm the Head of Resolution at FSCS. And I've worked at FSCS for just over eight years. My role, and that of my team, is to ensure that FSCS can respond effectively and protect customers when an authorised firm fails across any of our protection areas.

Nigel Yeates 00:57

Thanks Simon. So, today we're talking about the stages before people are potentially able to make a claim to FSCS. This is what goes on behind the scenes at FSCS and other organisations as well, before a firm is declared in default. And we talked about what FSCS means by 'in default' in our episode 12 mini-podcast, that Simon, you were also a guest on. So, everyone, please feel free to go back and listen to that one again as a reminder.

The 'in default' term is a specific rule-based test used to describe a firm which has essentially gone bust or become insolvent. And, what that really means, is it cannot pay claims, which are made against it. Right, with that clarification in place, let's get back to the stages that go on behind the scenes before that. This includes investigation work undertaken by FSCS to satisfy itself of two things; firstly, that there are protected claims against the firm, and secondly, that the firm is unable to or unlikely to be able to meet liabilities it owes customers as a result of a protected claim. There are specific rules which sets out the requirements that need to be met before we can pay compensation. These rules are set for us to follow by the regulators.

Simon Wilson 02:03

And Nigel, there's another important point to note about these investigations.

Nigel Yeates 02:07

Yeah, absolutely. It's important to highlight that investigations do not always result in us determining that there are in fact any valid claims. For example, in the last financial year, we declared 64 firms in default. However, in the background, we also completed a total of 432 investigations into firms to establish their solvency status and to confirm whether any of their former customers would have claims for compensation. Right, that's enough from me, Simon, let's get into this a little bit more from your perspective.

Simon Wilson 02:36

Thanks, Nigel. So, I guess from my side, I'd point out that beneath the headline claim numbers and amounts of compensation paid, there's a lot of claim related activity that takes place which may not be seen by stakeholders, levy payers, industry colleagues, and even our customers. Prepare is a core part of the FSCS strategy. It's all about ensuring we protect customers in the event of firm failures to maintain public confidence and of course, financial stability.

Take, for example, an insurance firm failure. It's vital that FSCS is as prepared as possible through early engagement with regulators and insolvency practitioners (IPs) so that when an insurance company does fail, FSCS can pay compensation as quickly as possible. This allows customers who rely on our compensation payments to purchase new, replacement policies from live trading firms, which not only increases consumer confidence, but also supports economic continuity by allowing customers to remain protected, and also engage with the insurance market.

Nigel Yeates 03:35

Thanks Simon, that's a really useful example. Right, let's get into the key topics, there are three areas we're going to have a bit more of a look at today. Firstly, can you tell us more about what FSCS does to prepare before an authorised firm fails?

Simon Wilson 03:48

Yeah, sure. So, FSCS is always scanning the horizon for potential firm failures, so it can be as prepared as possible to protect customers and also respond operationally if needed. We work very closely with other members of the regulatory family, sharing information intelligence on firms, which are at heightened risk of insolvency. And, this includes working with the Financial Conduct Authority, the Prudential Regulation Authority, the Financial Ombudsman Service, and also the wider industry so we can monitor trends and developments.

Nigel Yeates 04:19

Thanks Simon, that all makes sense. Secondly, can we think about complex cases? Can you talk more around that?

Simon Wilson 04:26

Absolutely, so some complex firm failures require quite detailed investigations in order to satisfy ourselves that we can declare a firm in default and consider claims for compensation. Examples would include firms which are engaged in activities with complex financial products that are new to the market or where it's unclear whether any of the firm's activities sit within the scope of FSCS protection. I think the important thing to note here is that although these investigations can be challenging and time-consuming, sometimes, they conclude that FSCS is unable to protect some customers under our rules which are set for us by the regulators.

Nigel Yeates 05:05

Yeah, absolutely. And that goes back to the point we discussed earlier in terms of those investigations. And so thirdly, let's talk about after a firm goes out of business.

Simon Wilson 05:14

Well, there are a number of steps that FSCS has to take before we can declare a firm in default. So firstly, FSCS must determine that a firm is unable, or likely to be unable, to pay claims made against it. And then we need to be satisfied that there is at least one protected claim against that firm.

Nigel Yeates 05:31

And can you tell us a bit more about the mix of claims feeding into these three key areas? We mentioned complex claims earlier.

Simon Wilson 05:38

Sure, the mix of claims that FSCS receives has changed significantly in the last four or five years. And overall, there is now a much lower proportion of claims which are more straightforward to process relating to regulated activities carried out by firms. These more straightforward claims are, for example, claims concerning activities and financial products, which are ones that we have an existing and high level of understanding and knowledge about.

Increasingly, however, our claim volumes relate to investment advice for personal pension products, or more complex investment portfolios, as well as pension transfer advice, which is a claim type, which can be particularly complex for us. I'd add that over the last four years, we've seen an increase in the number of firms falling to FSCS requiring a solvency investigation, where there was no insolvency practitioner in place. And in cases where there was no insolvency practitioner in place, it can be much more challenging to get the data from failed firms, which is required in order to investigate its activities, and also assess claims made against it. And, this can then lead to increased information-gathering timescales, which can affect how quickly FSCS is able to investigate a firm and pay claims made against it.

Nigel Yeates 06:50

Thank you, and what other questions do we get asked about in this area?

Simon Wilson 06:53

Well, we get asked about timescales for our investigations, even if we're unable to declare a firm in default because claims made against it are not protected, the investigation process can take upwards of 35 weeks, and sometimes longer, to complete for our most complex cases.

Nigel Yeates 07:11

And another question I've seen recently is around - Why don't complaints that have been accepted by the Financial Ombudsman Service get automatically processed by FSCS? Could you talk to that point?

Simon Wilson 07:21

Yeah, that's a great question. So, the tests that FSCS must apply for claims for compensation and the tests that the Financial Ombudsman Service applies to complaints are very different. The Financial Ombudsman Service decides complaints by reference to what is fair and reasonable in all circumstances of the complaint. Whereas, FSCS claims must pass a legal test, in respect of a civil liability, owed by the firm to the customer. And this means, that it's possible that a complaint which is upheld by the Financial Ombudsman Service may not necessarily be a claim, which can be upheld by FSCS, because it doesn't fall within our rules.

And I think it's worth adding, that though FSCS does consider information and evidence received from the Financial Ombudsman Service as a part of our decision-making process, it wouldn't be appropriate for FSCS to simply follow the Financial Ombudsman Service determination without conducting our own investigation because of the differing rules we operate under.

Nigel Yeates 07:23

That’s great. That's really clear. And thanks so much for all that useful information today, Simon. We also have more information and background on our website for our listeners to visit which is www.fscs.org.uk. And we hope everyone listening enjoyed this mini-podcast. You can find all of our podcasts on our website, and in the usual places you find your podcasts. Please do follow us wherever you listen to your podcasts, so you never miss a new episode. Thanks very much for listening.