Financial Services Compensation Scheme

Budget Update
January 2022

Chief Executive's **Statement**

Caroline Rainbird
Chief Executive

Our January 2022 FSCS Budget Update

As we welcome in a new year, I am pleased to introduce our latest *FSCS Budget Update*. You will notice this is streamlined and only includes the latest information regarding our management expenses which are consulted on each year by the PRA and FCA via the Management Expenses Levy Limit (MELL).

Our 2022/23 total levy forecast (including both management expenses and compensation costs) were presented in our November 2021 *Outlook*. I trust this early view of the following year's levy proved helpful for the industry.

2021/22 management expenses update

Our forecasted running costs (management expenses) for 2021/22 now stand at £85.3m which represents a £5.2m reduction against our budget announced in January 2021. The expected surplus (currently £5.2m) will be used to reduce the 2022/23 levy and will be factored into our next Outlook update in the spring.

For the same reason that we did not need to invoice the retail pool last year, the reduction is largely due to fewer firms failing and therefore not as many claims coming through as anticipated. However, as noted in our November 2021 *Outlook*, many of these firm failures may in fact occur in 2022/23 or beyond.

2022/23 management expenses budget

To meet our running costs, and ensure we are helping our customers get back on track as quickly as possible, we anticipate needing an annual budget of £95.5m - a 5% increase against our budget announced this time last year.

One of the key drivers behind this increase is an ongoing trend we are seeing of more complex claims with higher processing costs. For the next financial year, we expect complex claims to account for approximately 43% of all our claims decisions, an increase of 26% on 2021/22.

Of particular note is the rising number of claims coming through from customers who were given poor advice to move their pensions into unsuitable investments. These claims cost us more to process as they have longer handling times and require specialist staff to assess them and calculate the necessary compensation. To help illustrate this complexity, in the year to date, we have made over 9,000 requests to firms as part of gathering the supporting evidence needed for these claims. This is an 80% increase on the same time last year and a four-fold increase on 2018/19.

As well as more pension related claims, we are seeing more individual firm failures that are associated with multiple financial products. These types of claims are also time consuming to investigate. A good example is the failure of SVS Securities plc. This wealth management firm had offered a range of services to its clients, including advisory stockbroking, foreign exchange trading and discretionary fund management services. Consequently, a number of their former clients are making claims against a range of their products. Preparing these claims means tracking down multiple sources of information and carrying out a number of associated processes.

Keeping our costs low

As well as making strategic decisions to reduce spend across the business and keeping our controllable spend increase to no more than 3% this year, we are always looking for new opportunities to use technology to save time and money whilst delivering the right level of quality. As part of embracing Artificial Intelligence (AI), we have introduced a new data lake and search tool to find specific information in large data pools more quickly. During 2021, AI, although not used to determine whether claims are valid or not, enabled us to handle more than two years' worth of claims in six months, as well as avoid additional claims handling costs of around £9m.

AI is an essential part of our commitment to reducing our costs and our ambition is to transform into a data driven organisation that is continually investing in its technology and people to manage our controllable spend.

In addition, our recoveries work plays an important role in reducing the burden upon levy payers. In the first eight months of 2021/22, we recovered a little under £10m. Of this, around £900k was paid to customers who had losses in excess of our limits and the balance was used to offset levies in the relevant funding classes.

Looking to the future

Our management expenses, though dwarfed by the costs of the compensation we pay, are inextricably linked to the annual FSCS levy.

Although we have the right team and systems in place to efficiently process claims and make recoveries, it is important to be aware that the sheer complexity of claims means that we are likely to continue seeing increases in claims processing costs over the coming years as well as potential increases in the amount of compensation needed.

Our data shows a significant proportion of compensation is paid out in relation to poor advice and c. 70% relates to advice which occurred five years or more before a customer makes their claim. This lag in the system, as well as the growing complexity of claims, highlights the challenges ahead of us all and demonstrates the need for change.

At the end of last year, the FCA published its Compensation Framework Review discussion paper. This outlines several questions about the current compensation framework and we welcome the debate it opens up around developing a fair and balanced compensation model for both the industry and consumers. We understand the difficulties within this and getting the balance between consumer and industry responsibility will be an important and critical challenge to face into collectively.

We want to see a compensation framework in place that is fair for the industry but allows us to put as many people back on track as possible when this is needed. We are thinking hard about how to tackle these matters and will continue to focus our intelligence and analysis capabilities to that end. I encourage all of our stakeholders to join the debate to find solutions that support the health of the whole of the financial services sector and customers, and the wider economy they serve.

Caroline Rainbird
Chief Executive

FSCS Budget **Update**

January 2022

Here we present our anticipated management expenses (running costs) for 2022/23 and provide the latest forecast regarding our management expenses for 2021/22.

Please note: the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) will also be consulting on our 2022/23 management expenses as part of the yearly Management Expenses Levy Limit (MELL) consultation.

Please see our November 2021 *Outlook* update for details of the total levy figures, including compensation costs, forecasted for 2022/23. Our next update for the 2022/23 levy (including both management expenses and compensation costs) will be published in the spring.

2022/23 Management expenses budget

- The proposed budget for 2022/23 is £95.5m which represents a **£5m (5%) increase** on the 2021/22 budget that was announced in January 2021. It includes:
  - a **£3.4m** increase in volume related costs – i.e. all costs associated with investigating and assessing claims; and
  - a **£1.5m** increase in controllable costs - this includes rent and costs associated with our critical business support functions such as HR and IT.
- The reasons for these increases include:
  - An ongoing trend in increasing numbers of complex claims that require additional time, resource and skilled expertise to process, e.g. for pensions and investment advice.
  - In 2022/23, we expect complex claims to account for approximately 43% of all decisions. This is an increase of 26% on 2021/22.
- Given an anticipated rise in volume and complexity driven costs, we have made strategic choices to reduce our controllable costs and ensure this increase is kept below 3%. After adjusting for inflation at 3%, our controllable costs are in fact lower than our 2021/22 management expenses budget.
- To ensure we have the funds in place to process a significant increase in unexpected firm failures, we propose an unlevied reserve of £15m (which is the same amount included in the 2021/22 budget announced in January 2021). This gives us the flexibility needed to handle any unexpected rise in claims, especially given the current economic climate.

- The PRA and FCA are consulting on an overall MELL of **£110.5m**. This takes into account a **budget of £95.5m** and an unlevied reserve of **£15m**. Please note, we do not intend to use these contingency funds - (£15m), hence they are not invoiced for until deemed necessary.
- Figure 1 shows our management expenses budget for 2022/23, broken down according to type of costs (category), compared to the 2021/22 budget announced in January 2021.
- Figure 2 shows our management expenses split by PRA and FCA classes for 2022/23. Information on when the invoices will be sent to firms can be found in our November 2021 *Outlook* (see 'Payment on account' section towards the end of the page).

2021/22 Management expenses update

- We expect to end this financial year £5.2m below budget in comparison with the 2021/22 budget announced in January 2021. This is because:
  - Fewer firm failures occurred and therefore fewer claims came through than expected. As a result, costs associated with processing customer claims were 16% lower than expected;
  - We now expect to make around 14,500 fewer claims decisions than originally announced. Most of these relate to claims we had anticipated receiving for the General Insurance Distribution and Investment Provision classes.
- We do not expect to utilise the unlevied reserve (£15m).
- Any surplus (currently £5.2m) will be used to help offset the levy for the relevant classes in 2022/23 and will be factored into our spring levy update.
- It is important to note however, despite the fact we have seen fewer claims, we have seen an increase in the proportion of claims that are more complex and therefore, costlier to process. This includes claims where customers may have been given unsuitable advice to transfer out of a defined benefit pension scheme.
- Figure 3 shows our latest management expenses update for 2021/22 compared to the budget announced in January 2021.

Figure 1: 2021/22 Budget vs. 2022/23 Budget

Category	2021/22 Budget (announced January 2021)			2022/23 Budget (January 2022)			Variance	
	Budget (£m)	Volume & complexity driven (£m)	Volume driven (£m)	Budget (£m)	Controllable costs (£m)	Volume & complexity driven (£m)	Total (£m)	Total (%)
Outsourced claims handling	21.8	-	21.8	21.7	-	21.7	(0.1)	(0.5%)
Internal claims processing	15.8	5.6	10.3	18.9	6.3	12.6	3.0	19%
Core support: IT, facilities, central services	31.9	31.1	0.8	33.7	31.1	2.6	1.8	5%
Claims handling infrastructure and support subtotal	**69.5**	**36.7**	**32.8**	**74.2**	**37.4**	**36.8**	**4.7**	**7%**
Funding readiness total	**8.2**	**8.2**	**-**	**8.0**	**8.0**	**-**	**(0.2)**	**(2%)**
Consumer protection	0.9	0.9	0.1	0.9	0.9	-	-	-
Depositor protection	3.4	3.2	0.2	3.5	3.5	-	0.1	3%
Recoveries	2.6	2.3	0.3	3.0	3.0	-	0.4	15%
Investment / change	4.0	4.0	-	4.0	4.0	-	-	-
Pension deficit funding	1.9	1.9	-	1.9	1.9	-	-	-
Protection, recoveries, investment & pension deficit subtotal	**12.8**	**12.3**	**0.6**	**13.3**	**13.3**	**-**	**0.5**	**4%**
Total management expenses	**90.5**	**57.2**	**33.4**	**95.5**	**58.7**	**36.8**	**5.0**	**5%**

Figure 2: 2022/23 management expenses split according to PRA/FCA claims costs

	2021/22			2022/23			Movement		
	FSCS total costs (£m)	Fee block allocation		FSCS total costs (£m)	Fee block allocation		FSCS total costs (%)	Fee block allocation	
		PRA (£m)	FCA (£m)		PRA (£m)	FCA (£m)		PRA (%)	FCA (%)
Base costs total (split 50:50)	**28.9**	**14.4**	**14.4**	**29.9**	**15.0**	**15.0**	**4%**	**4%**	**4%**
Specific costs									
Deposits	14.8	14.8		14.1	14.1		(5%)	(5%)	
General Insurance Provision	6.0	6.0		7.2	7.2		20%	20%	
Life and Pension Provision	-	-		-	-		-	-	
General Insurance Distribution	7.5		7.5	5.9		5.9	(21%)		(21%)
Life Distribution and Investment Intermediation (LDII)	21.5		21.5	27.7		27.7	29%		29%
Investment Provision	9.7		9.7	9.7		9.7	-		-
Home Finance Intermediation	2.1		2.1	1.0		1.0	(55%)		(55%)
Debt Management	-		-	-		-	-		-
Specific costs total	**61.6**	**20.8**	**40.8**	**65.6**	**21.2**	**44.3**	**6%**	**2%**	**9%**
Management expenses total	**90.5**	**35.2**	**55.3**	**95.5**	**36.2**	**59.3**	**5%**	**3%**	**7%**

Figure 3: 2021/22 Budget vs. 2021/22 Latest Update

Category	2021/22 Budget (announced January 2021)			2021/22 Forecast (latest update)			Variance	
	Budget (£m)	Control-lable costs (£m)	Volume driven (£m)	Fore-cast (£m)	Control-lable costs (£m)	Volume driven (£m)	Total (£m)	Total (%)
Outsourced claims handling	21.8	-	21.8	14.2	-	14.2	(7.6)	(35%)
Internal claims processing	15.8	5.6	10.3	18.7	5.8	12.9	2.9	18%
Core support: IT, facilities, central services	31.9	31.1	0.7	31.9	30.9	1.0	-	-
Claims handling infrastructure and support subtotal	**69.5**	**36.7**	**32.8**	**64.8**	**36.7**	**28.1**	**(4.7)**	**(7%)**
Funding readiness total	**8.2**	**8.2**	**-**	**8.2**	**8.2**	**-**	**-**	**-**
Consumer protection	0.9	0.9	0.1	0.8	0.8	-	(0.1)	(15%)
Depositor protection	3.4	3.2	0.2	3.2	3.2	-	(0.2)	(5%)
Recoveries	2.6	2.3	0.3	2.4	2.4	-	(0.2)	(7%)
Investment / change	4.0	4.0	-	4.0	4.0	-	-	-
Pension deficit funding	1.9	1.9	-	1.9	1.9	-	-	(1%)
Protection, recoveries, investment & pension deficit subtotal	**12.8**	**12.3**	**0.6**	**12.3**	**12.3**	**-**	**(0.5)**	**(4%)**
Total management expenses	**90.5**	**57.2**	**33.4**	**85.3**	**57.2**	**28.1**	**(5.2)**	**(6%)**

Financial Services Compensation Scheme
10th Floor
Beaufort House,
15 St Botolph Street,
London, EC3A 7QU

0800 678 1100
www.fscs.org.uk

FSCS Linkedin
FSCS on Twitter @FSCS
FSCS YouTube channel FSCSProtected

January 2022