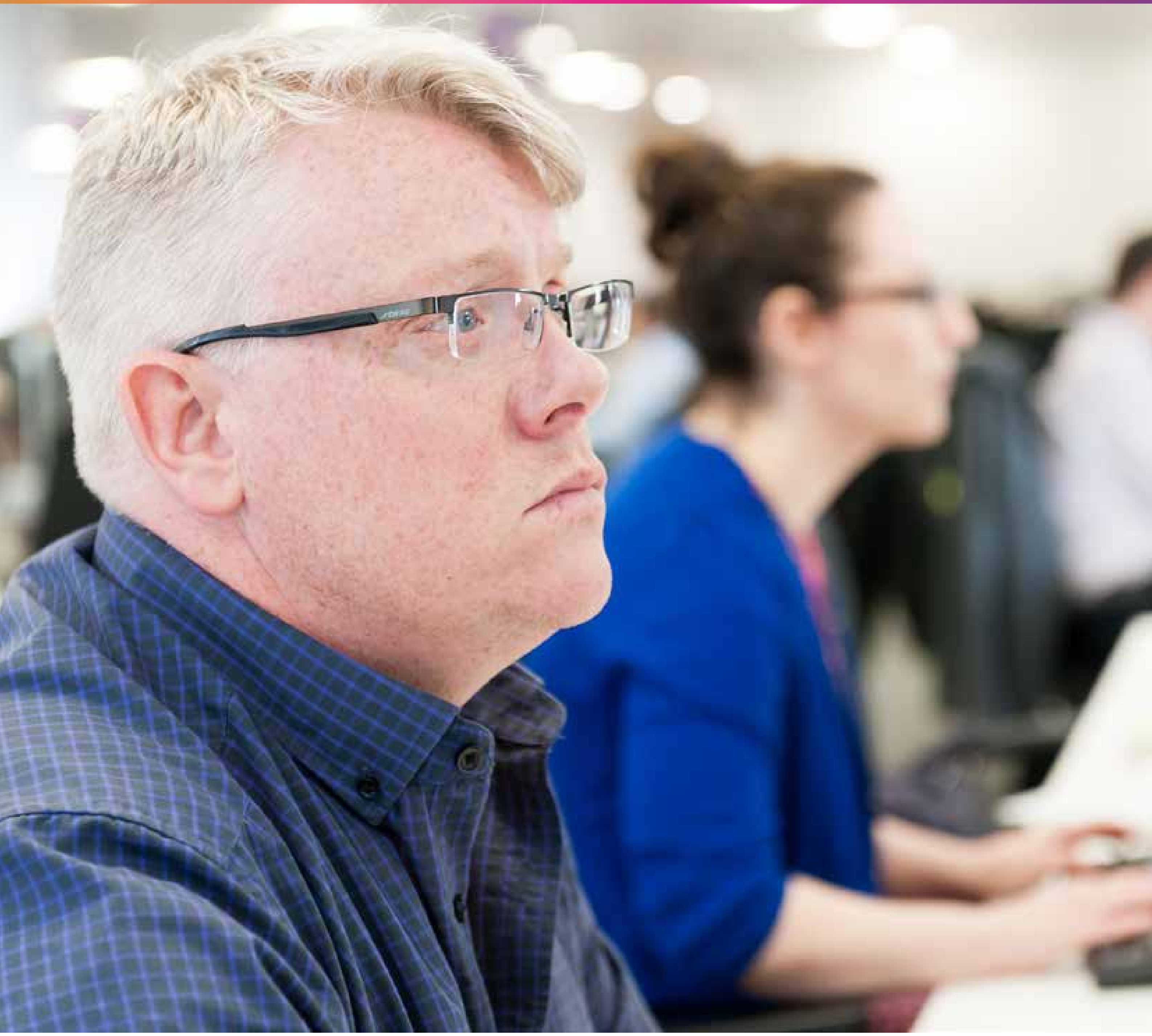
Plan and Budget: 2017/18

Financial Services Compensation Scheme



Strategic Direction

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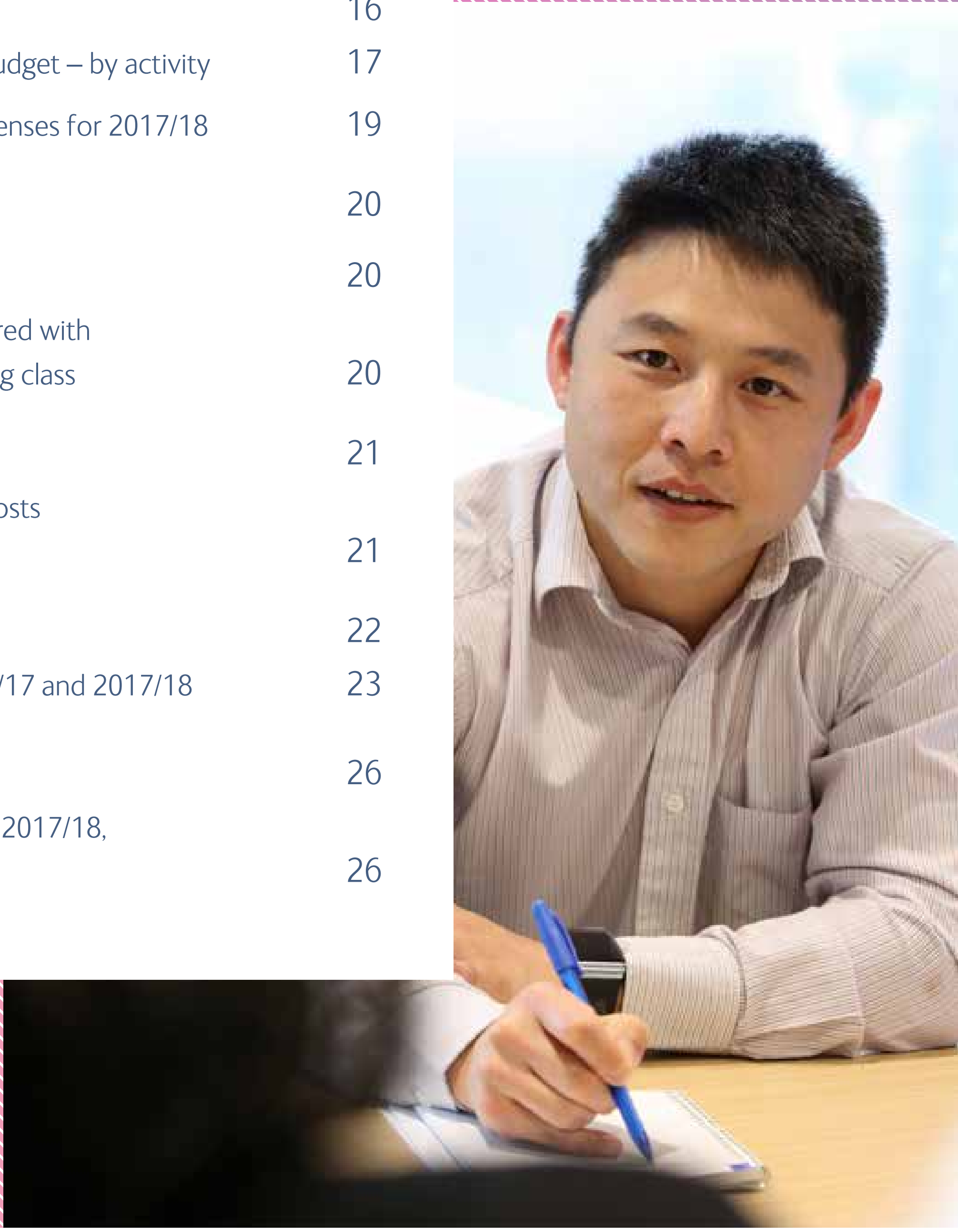


Chair’s Foreword

Lawrence Churchill
Chairman

We publish our Plan and Budget annually, primarily for the benefit of our levy payers, to support the consultation which the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) undertake on our management expenses for the year ahead.

This year sees two innovations that the FSCS Board hopes will promote transparency and our accountability to the firms that meet FSCS’s costs through the levy.

The first is embodied in this document. We are setting out our proposed budget next year on the basis of activity rather than input. This makes it much easier to see what we are proposing to spend to achieve the different outcomes for which FSCS is responsible.

It also makes it easier to understand what drives our costs.

The volume of claims we receive stands out here, accounting for a little more than half of our management budget of £69m. The cost of handling these claims – around £35m – is rising steeply in 2017/18, by nearly £5m, because of the growth in complex intermediation claims in the life and pensions and investment sectors.

However stakeholders may be surprised to learn that claims, though the largest driver of our costs, is just one of seven.

Our budget also reflects:

- preparedness for a major failure or another crisis (just over £6m): the main element here is the cost of a revolving credit facility with a consortium of banks which would enable us to finance a seven day pay-out in the event of a bank or building society or other urgent failure;

£9m

Continuing investment to maintain IT infrastructure, improve customer service and more

- our judgment about what we need to spend – around £3.5m in 2017/18 – to discharge our statutory responsibility to maximise recoveries from the estates of failed businesses or from third parties responsible for losses we have compensated. This is an important part of what we do and offsets the costs of compensation for firms. I very much hope that the impending sales of parts of the Bradford & Bingley mortgage book will enable us finally to clear up the legacy of the 2008 failures in the year ahead;
- maintaining awareness of deposit protection at least at 70% of UK adults to ensure confidence and maintain stability if a bank or building society is rumoured to be in difficulty – a cost next year of just over £3m. This spending supports FSCS's own communications efforts which, in turn, complements the work of banks, building societies and credit unions, which advise their customers of FSCS protection;
- supporting the Bank of England – at a cost of £1.5m – in the review of Single Customer View (SCV) files, which would inform resolution decisions and, in many cases, underpin a fast pay-out of depositors if a bank, building society or credit union fails;
- the continuing investment needed – £9m in 2017/18 – to maintain our IT infrastructure, to improve our customer service, enhance controls and drive efficiency, including promoting the take-up next year of our digital service; and
- the cost of repairing the deficit in our pension scheme – nearly £2m.

So FSCS is far from simply a claims handling operation. We run a complex business, which aims to protect consumers and support financial stability, but also to mitigate the costs of that protection for the industry.

The second innovation will become apparent when we report on 2016/17 in the summer. Up to now, we have produced an Annual Report and Accounts, which provide both audited information about FSCS's accrued income and expenses and information about cash flows in each of the FSCS classes. These cash flows determine the levies we charge each year.

In future we shall publish a separate document covering these cash flows, so that levy payers can trace through the year how assumptions have changed from the levies set in April to our mid-year report in *Outlook*, to the end-year position.

We hope this will also enhance accountability.

Chief Executive's Overview

Mark Neale
Chief Executive

£3m
Fall in management expenses budget

FSCS is now just over halfway through a five-year strategy, which will take us through to March 2019. 2017/18 will be the fourth year.

Despite the many intervening events, FSCS's Board continues to think that strategy holds good, but we intend now to put more emphasis on two dimensions: improving our service to customers and achieving better value for money.

That is reflected in the budget we are proposing for 2017/18 which, out-sourced claims-handling apart, cuts costs by nearly £3m. A 78% rise in the expected volume of non-deposit claims against 2016/17 adds, however, over £4.5m to out-sourced claims handling costs and results in a budget of just over £69m – up £1.8m on this year.

Key to both better customer service and better value are the steps we are now taking to exploit the investment made in a new platform for non-deposit claims. This platform, which we share with our outsource partners, has been live since May 2015.

After some initial teething troubles, which adversely affected our service in the opening months of 2016/17, this investment has now begun to pay off. We have largely eliminated paper from claims handling and, in the process, improved controls. Customer satisfaction is at around 76% and rising. The like-for-like cost of handling non-deposit claims are projected to fall by about 14% by March 2017.

Our focus in 2017/18 will be on promoting and developing our digital service. Customers have been able to make and track claims online since December 2016. We want to extend this service to claimant representatives, such as claims management companies, in 2017/18 and aim to receive the vast majority of claims applications online by March 2019.

£5m
Savings at current claims volumes

This will make life easier for our customers, who will be guided through the process and able to provide supporting evidence online. It will also improve efficiency by reducing the need to seek further information from customers, by eliminating errors and by reducing the need for customers to chase progress as claims will be tracked online.

We shall also review our outsourcing strategy in 2017/18, when we may reduce the number of partners while increasing contract lengths. This will create incentives for better value and for innovation.

Taken together, we expect these changes, which account for around 30% of our £9m "change" budget, to enable us to raise customer satisfaction above 80% by March 2019 and, once fully implemented, to yield a saving of around £5m at current claims volumes.

Meanwhile we are taking other steps in 2017/18 to cut our costs. We shall reduce our headcount by 6% by March 2018. This contributes to a fall in our core costs – the central costs of maintaining FSCS's capacity to manage claims handling and to plan for present and future failures.

We are also reducing the amount we spend on achieving recoveries and on maintaining awareness of deposit protection. And our overall change budget falls again by about £1m.

FSCS has limited control over the amount of compensation we pay annually. This is a function of the volume and nature of the eligible claims we receive as a result of firm failures – which are difficult to predict. The resulting volatility of our levies – and the problems it presents for our levy payers – is currently the subject of a review by the FCA.

We have announced separately the need for supplementary levies this year and our indicative forecast for 2017/18 shows the potential for a further call on the retail pool – to fund the costs of SIPP-related claims on the life and pensions intermediation sector.

We do, however, have much greater control over our own management costs, though those too are sensitive to claims volumes. This budget demonstrates our continuing commitment to hold those costs down while improving our service to customers.

We welcome feedback on our plans for 2017/18.

Strategic Direction: taking forward our Five Year Vision

FSCS exists to provide a trusted compensation service for customers of failed financial services firms, which also promotes confidence in financial services.

To minimise costs to levy payers we seek to operate as efficiently as possible and to maximise recoveries from the estates of failed firms and from those third parties responsible for the losses we have compensated.

FSCS is more than halfway through its five-year strategy. The strategy aims to enhance FSCS's key capabilities and in particular, the responsiveness of our service to customers.

This service is delivered through a model that is mainly outsourced, enabling us to respond efficiently to an unpredictable and volatile workload.

Since the financial crisis, we have invested in improving customer service, enhance control, lower costs and above all, to ensure that FSCS is able to meet all foreseeable future challenges, including another crisis should one occur.

We have had the ability since 2011 to repay deposits in banks, building societies and credit unions in seven days for the great majority of depositors.

In 2015, we brought our outsource partners onto a new claims handling platform, so facilitating the quick and safe electronic transfer of claims and enabling us to mobilise more rapidly in response to rising demand.

After a pilot in December 2015, our online service for customers went live in December 2016. Customers can now make and track the progress of claims online.

Although we expect to make some further investments in 2017/18 to open the online service to claimant representatives, our "change" spending will be half what it was at the peak of this transformation programme and will now switch towards the maintenance of our systems and continuous improvement.

We set out below a summary of the progress we have made against each imperative in taking forward the strategy in 2016/17 (its third year), as well as our commitments for 2017/18.

Serving our customers (previously modernising our service)

We're now making strong progress on *serving our customers* (renamed from "modernising our service", so the outcome is clearer). By December 2016, we were delivering 76% customer satisfaction (our Vision target was 70%).

In 2016, we focused on realising the benefits of the investment we had made in a new claims-handling process. In April we simplified our application forms, and included better guidance on how to complete them, which helped improve initial customer satisfaction with completing our forms from 63% to 86% by November. We also worked closely with our business partners to speed up service and deliver decisions more quickly, which has contributed to the improvement in overall customer satisfaction with FSCS to 76%.

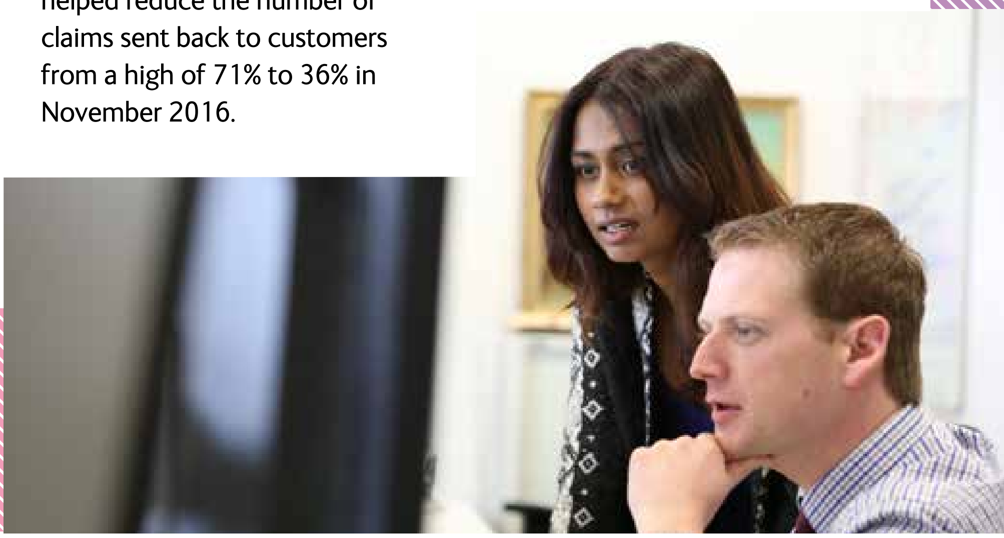
Achievements in 2016/17:

- Overall customer satisfaction increased from 59% in April to 76% in November.
- Customer trust in FSCS to handle their claims fairly was at 82% by December 2016.
- 27,195 claims decided in the first three quarters of 2016/17.
- 91% of claims turned around within service level (target of 90%) by end November 2016.
- We re-designed our claims forms to explain more clearly what information we need and also fine-tuned our processes. This helped reduce the number of claims sent back to customers from a high of 71% to 36% in November 2016.

Commitments for 2017/18:

- We expect to handle 28,316 claims with at least 90% turned around within our service level.
- Customer satisfaction to rise to at least 80% by the end of 2017/18.
- We shall monitor and report on customer trust in FSCS to gauge whether or not we're achieving our corporate mission[1].

[1] FSCS's mission is to provide a trusted compensation service for customers, which raises public confidence in the financial services industry.



82%
Customer trust in FSCS

Diversifying how we deliver compensation to provide maximum convenience and continuity for customers

Our strategy aims to meet the needs of customers and help restore their confidence in the financial services industry. We're using our customer experience research to change processes, guide our technology platform and shape our investment in this area. We also wish to explore faster payment channels as an alternative to cheques.

Achievements in 2016/17

- We launched our online service in December 2016, where claims can be submitted directly by customers. We aim to have 80% of claims submitted in this way by 2019.
- We extended the opening hours for our online support helpline – we're now open until 9pm on weekdays and 9am - 2pm on Saturdays.
- We have improved the design and content of our customer correspondence to make it easier to understand and more customer-friendly.

Commitments for 2017/18

- We shall open our online claims service for claimant representatives (such as claims management companies) whilst continuously improving the existing online experience.
- We shall undertake a review of options for accelerated payouts primarily in the event of a bank, building society or credit union failure in order to provide faster liquidity to customers than our current method of payment by cheque or cash from a local post office.

Improving value for money (VFM) to drive value for levy payers and strengthen accountability

As the Chair describes in his foreword, FSCS's costs are driven by a number of different factors. However by far the biggest is the volume and mix of claims we handle. It follows that our focus on improving value for money will continue to centre on the process of handling claims. Our outsourced business model enables us to transfer the volume risk to outsource partners who are better able to manage it.

In 2017/18, we intend to review our sourcing strategy to extract further value from these arrangements. We may reduce the number of outsourcers but extend arrangements to develop closer partnerships.

The investment we have already made in a common claims handling platform and in a digital service will enable us to reduce the costs of processing claims and improve the efficiency with which we deal with unexpected changes in the volume and mix of claims.

Achievements in 2016/17:

- We will have reduced like-for-like costs of outsourced claims handling by 14% by March 2017.
- We reviewed all spending by activity type to drive understanding of areas where savings can be realised.
- We implemented an online procurement system, making tendering more efficient for FSCS and potential suppliers.
- We promoted the importance of VFM to staff through internal communications and the annual staff survey.

Commitments for 2017/18:

- We shall promote the use of our online service to individual customers and open the service to claimant representatives, so reducing transaction costs.
- We shall revise and begin implementation of our outsourcing strategy with transition to our new model taking place in 2018.
- We shall produce an ongoing annual review of buying plans to maximise potential savings and other benefits as supplier contracts are renewed.
- We shall reduce external contractor spend.

Deepening contingency planning to be ready to respond effectively to crises

We continue to work closely with the authorities to identify and respond to emerging risks. FSCS has documented and agreed contingency plans, protocols and working arrangements with UK authorities. FSCS continues to seek opportunities to develop resolution planning options to ensure the most appropriate outcomes and least disruption for consumers.

Our work continues with the authorities and our partners to make sure that processes and contingency plans are developed and exercised routinely across the full range of FSCS protection. This work has been focused on a large scale crisis management exercise, as well as enhanced testing of our ability to recover from a major IT failure.

These activities will continue to reinforce our ability to respond to failure and ensure that in times of stress, there is no doubt about roles, responsibilities and responsiveness of the important protection FSCS provides.

Achievements in 2016/17

- We enhanced testing of our ability to recover from a major failure of our IT systems.
- We tested our crisis management approach and capability, to ensure that we are able to respond in a timely and effective manner to disruptive events.
- We undertook a review of our continuity plan, across the entire business, validated through testing eg. an exercise simulating a large firm failure and an incident restricting access to our facilities. The independent facilitator largely approved our existing crisis management protocols – with a few helpful lessons learnt.

Commitments for 2017/18

- We shall carry out reviews of Single Customer View files of deposit takers to support the Bank of England and our own planning.
- We shall sustain the capability to pay out to depositors supporting resolution strategies determined by the Bank of England.
- We shall plan and commence “stress testing” of our payout and funding capability as required by the European Banking Authority.
- We shall review our contingency plans with the authorities.
- We shall re-test our disaster recovery capability.

Achieving excellence as a creditor

We shall continue working with HM Treasury (HMT) on sales from the Bradford & Bingley (B&B) mortgage estate, with a view to repaying the FSCS debt owed by B&B.

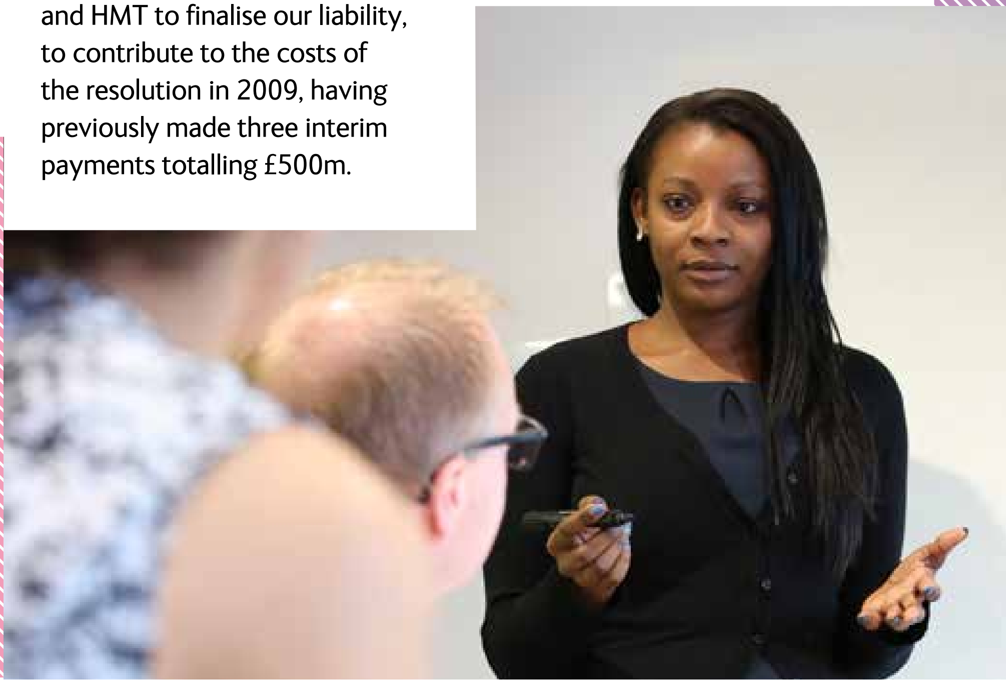
FSCS will also look to continue PPI recoveries action against various lenders, based on the Supreme Court's decision in Plevin v Paragon Personal Finance (2014). Finally, FSCS will also look to develop a new reporting approach to recoveries showing more clearly the expenditure incurred against recoveries.

Achievements in 2016/17:

- We received the final dividend from London Scottish Bank, bringing the total dividend to 63.4% and concluding our involvement in this estate.
- We continue to receive dividends from the estates of Kaupthing and Heritable to recover costs for the levy payers.
- We continue to work with the administrators of Dunfermline and HMT to finalise our liability, to contribute to the costs of the resolution in 2009, having previously made three interim payments totalling £500m.

Commitments for 2017/18:

- We shall pursue further recoveries action against various lenders for Payment Protection Insurance compensation costs.
- We shall continue to work with HMT on a sale of the B&B mortgage book to allow FSCS's debt to HMT to be repaid.
- We shall develop a new reporting format for recoveries.



Raising awareness of the protection FSCS provides

If FSCS is to fulfil its role of maintaining trust and confidence in financial services, we must also continue our efforts to ensure that the public knows about FSCS protection. Our research demonstrates that the more aware people are of us, the more confident they are. This helps to generate trust in the industry and aids financial stability.

We continue to make good progress on work to build consumer awareness of the Scheme by working closely with the industry. Awareness among all UK adults is now at a high level. As a result, this year, we were able to reduce spending in this area.

Achievements in 2016/17

- Consumer awareness of deposit protection is currently at 77% (up from <10% when the programme began). Depositors confidence that "my money is safe" is 78%, with a similar number saying the FSCS campaign makes them feel protected. 78% are reassured knowing FSCS exists and 63% say they trust banks and building societies more knowing FSCS protects them.
- FSCS featured in almost 5,000 media articles and about 11,000 social media mentions during the year. Our PR messages reached 85% of all UK adults an average of 105 times during the year according to independent evaluation. The top messages were: there are limits to the protection FSCS provides; the range of FSCS protection; FSCS being funded by the industry.

Commitments for 2017/18

- We shall maintain awareness of deposit protection of at least 70% of the population.
- We shall build on the work we commenced this year with the insurance industry to raise consumer awareness of FSCS protection.
- We shall seek to agree voluntary guidelines with deposit takers for the use of the FSCS protected badge on relevant materials.
- We shall continue our PR and stakeholder work across the full range of FSCS protection, eg. following the failures of firms.

£50

Average saving per employee

Engaging our people to be even more agile and professional

The commitment of our people to excellent service is a given and is central to the results we achieve. During 2016, we built on that commitment by developing our people's skills and knowledge; giving them access to new tools and technology and introducing a new reward package which reflects what staff value. We will equip our people to respond to, and embrace, change, so that we can continue to rise to whatever challenges we may face. In 2017, our goal is to recruit and retain people who have the required competencies and skills to work at FSCS, drive up performance standards, enhance innovation and deliver our corporate mission.

Achievements in 2016/17:

- We launched a new flexible benefits portal which is delivering an average saving of £50 per employee, with increased choice and 94% employee engagement.
- We saved more than £500,000 on like-for-like, year-on-year costs for agency fees relating to consultants.
- We successfully launched our new HR and payroll system.

Commitments for 2017/18:

- We shall implement Fuse – our dynamic e-learning and social communication platform for our outsource partners to facilitate speed and ease of up to date training.
- We shall roll out a new approach to talent management and performance achievement (including the development of a bespoke 360 degree evaluation tool).
- We shall assess the FSCS against the Generation VI Investors in People Standard.

Management Expenses

£0.7m
Fall in spending on major recoveries

The FSCS Board approved a management expenses budget of £69.2m.

Excluding the costs of our outsourced claims handling, this budget provides for costs to fall by just under £2.7m compared to the 2016/17 budget, but a 78% rise in non-deposit claims (against our budget) adds £4.5m to expected costs. As a result, the proposed budget is £1.8m higher than the 2016/17 budget. The PRA and FCA are consulting on the FSCS management expenses levy limit based on this budget.

In figure 1, as indicated in the Chair's foreword, we show these costs on an activity basis. This has been developed through the year, so that the methodology is indicative – but it illustrates with greater transparency the major influences on FSCS's costs.

From this, the key drivers of the 2017/18 budget are:

- **A rising number of projected claims** (particularly for the more complex SIPP-related claims) has increased the budget for variable outsourced claims handling costs by £4.5m. Excluding this volume-driven change, the budget falls for a third successive year.
- **A reduction of £0.2m in core costs** needed to run FSCS's operations and be ready to respond to claims, which includes a 6% reduction in budgeted headcount.
- **A further reduction of £1.1m in strategic change investment**, as we continue to consolidate and enhance our new infrastructure for claims handling following the launch of our claims portal to the general public in December 2016.

We are also changing the focus of our "change" spending away from transformation and towards improvement and maintenance. Of the total budget of £9m, half will go on replacing equipment and systems and a fifth on continuous improvement, which we split out further on page 18.

A fall of £0.7m in spending on recoveries, as the litigation against certain lenders for PPI mis-selling has concluded, although we continue our action against others. We have further reduced costs for major banking failures as this recoveries work draws to a close. UKAR (United Kingdom Asset Resolution Limited) and HMT have commenced a process of asset sales that could enable the repayment of the debt due to FSCS.

£69.2m

proposed management expenses budget for 2017/18

Figure 1: Management expenses budget – by activity

	2016/17 Budget (£ million)	2017/18 Budget (£ million)
Core (internal) claims handling	15.8	14.7
Core support	18.4	19.3
Core sub-total	**34.2**	**34.0**
Single Customer View	1.5	1.5
Recoveries	4.3	3.6
Consumer awareness	3.8	3.1
Investment / Change	10.1	9.0
Non-outsourced costs: total	**53.9**	**51.2**
Outsourced claims handling	11.6	16.1
Pension deficit funding	1.8	1.9
Total management expenses	67.4	69.2
Contingency reserve for major failure	5.3	5.3
Total management expenses levy limit	**72.7**	**74.5**

"Change" spend

Of the sums allocated to Investment / Change (figure 1), now that we have replaced our claims handling platform, the spend is split into spending on sustaining existing systems and activities, improving processes and technology and transforming our service with new initiatives. The £9m budget will fund:

- Transformational change projects that will alter our business model and drive significant future results (c. £2.5m) eg. the promotion and development of our online service, reviewing and updating our outsourcing model;

- Continuous improvement projects that drive efficiency and our ability to respond to pressure such as increased claims volumes (c. £1.8m) eg. reviewing our end-to-end claims process to reduce workload further and increase speed of settlement: developing a toolkit for all teams to be able to drive improvement in the work they do, overhauling our website;
- Operations sustainability projects that enable FSCS to fulfil core activities (c. £4.4m) eg. keeping IT infrastructure operating and supported, replacing end-of-life IT equipment, ensuring data security standards and maintaining our core claims handling system.

The budget will also fund our work on a faster payout channel for deposit claims (c. £0.3m).

Annex 1 breaks down FSCS's management expenses budget for 2017/18, alongside the budget for 2016/17.

Although the precise costs may vary, the expected allocation of "change" spend between PRA and FCA classes is expected to be approximately 37% / 63% respectively.

Allocation to funding classes

Like last year, we have split the 2017/18 management expenses budget between firms regulated by the PRA and FCA; as in figure 2.

The FSCS 2017/18 management expenses budget is split between the PRA and FCA industry sectors or funding classes. All costs have been identified as either "specific" or "base" costs. Specific costs are allocated to the relevant sectors and base costs spread between all firms.

The costs continue to be allocated as follows:

- Costs that are wholly attributable to a type of business are allocated to that specific sector.
- Overhead costs are split between specific, on the basis of the proportion of frontline staff full time equivalents (FTE), and base costs, on the proportion of support staff FTE. The sector-specific overhead costs are then allocated across the classes using timesheet data.
- Total base costs are split 50:50 between the PRA and FCA (who will then apply their overall class allocation matrix to spread between their fee classes).

£5.3m

Reserve for 2017/18, the same level as the last three years

Figure 2: Split of management expenses for 2017/18

	FSCS Total costs (£ million)	PRA fee block allocation (£ million)	FCA fee block allocation (£ million)
Base costs total	**27.9**	**13.9**	**13.9**
Specific costs			
Deposits (SA01)	11.1	11.1	-
General Insurance Provision (SB01)	4.1	4.1	-
General Insurance Intermediation (SB02)	6.5	-	6.5
Life and Pensions Provision (SC01)	0.0	0.0	-
Life and Pensions Intermediation (SC02)	7.5	-	7.5
Investment Provision (SD01)	-	-	-
Investment Intermediation (SD02)	10.7	-	10.7
Home Finance Intermediation (SE02)	1.4	-	1.4
Specific costs total	**41.3**	**15.2**	**26.1**
Total	**69.2**	**29.2**	**40.0**

Contingency reserve for major failure

The proposed Management Expenses Levy Limit (MELL) includes a contingency reserve, within which FSCS can increase management costs beyond the budget without further consultation in response to unforeseen failures. This reserve is not levied on the industry unless in response to a major crisis or urgent need. The reserve for 2017/18 is being consulted on - it is the same level as the last three years.

The reserve level does not reflect the specific or known costs of any particular future failures. It is indicative of the short-term costs of, for example, dealing with large defaults within tight timeframes.

We do not expect to raise more than our budgeted expenses, unless there is a specific event or events that require us to do so. In line with our usual practice, we will liaise with the relevant parties, such as the PRA, FCA and trade bodies, before raising a levy against this reserve.

The failures of Enterprise and Gable insurance companies and the higher than expected volumes and costs of SIPP-related claims created additional management costs which FSCS was unable to absorb within the 2016/17 budget year. As a result, FSCS is likely to utilise a portion of the unlevied contingency reserve, for the first time, to meet these costs in Q1 2017. The final amount will be confirmed in February 2017.

Compensation costs and levies

Annual Levy 2017/18

Our indicative forecasts for compensations costs and levies in the year ahead reflect a number of assumptions. The most important is the volume and cost of claims we expect to receive during the year. We discuss how we arrive at these assumptions below.

We also, however, have to take into account the expected surplus or deficit for each funding class at the end of the funding year on 30 June 2017, the forecasts for recoveries which offset compensation costs and the management expenses attributable to each class. The surpluses or deficits with which we end one year and begin the next are themselves influenced by decisions taken about supplementary levies in the preceding year.

In 2016/17 we decided, consistent with our policy, to raise supplementary levies on three industry sectors – life and pensions advisers, general insurers and mortgage advisers – and these levies are reflected in our year-end forecasts; a £50m refund is to be made to the investment intermediation sector. The indicative 2017/18 annual levy is £378m. This compares to the £337m final levy raised in 2016/17 – although £64m of supplementary levies (net of refunds) were also raised. The amounts are detailed in figure 3. In addition, we forecast that the levy for the interest on the outstanding bank legacy loan will be £202m. As usual, we will review and confirm the final levies for each class in April.

Figure 3: 2016/17 final levy compared with 2017/18 indicative levies by funding class

Funding classes	2016/17 Final levy (£ million)	2016/17 Supplementary levies/(refunds) (£ million)	2017/18 Indicative levy (£ million)	Variance (£ million)
Deposits (SA01)[2]	24	-	11	(13)
General Insurance Provision (SB01)	91	63	52	(102)
General Insurance Intermediation (SB02)	8	-	13	5
Life and Pensions Provision (SC01)	-	-	-	-
Life and Pensions Intermediation (SC02)[3]	90	36	171	45
Investment Provision (SD01)	2	-	9	7
Investment Intermediation (SD02)	94	(50)	84	40
Home Finance Intermediation (SE02)	6	15	14	(7)
Base costs	**22**	**-**	**24**	**2**
Total	**337**	**64**	**378**	**(23)**

[2] This does not include the levy for interest costs on the outstanding bank legacy loan which we forecast to be £302m, to be offset by recoveries of £100m.

[3] Capped at £100m in 2016/17 £26m paid by retail pool. In 2017/18 amounts over £100m will also be funded from the retail pool - see page 25.

Our calculations

Under our rules we may levy for the higher of the expected costs calculated under a 36-month approach or the traditional 12-month basis. We calculate the expected compensation costs using both methods. In most classes, we have applied the 12-month forecast, except for investment intermediation, where the levels of claims we continue to receive support a higher trend. As shown below, we have therefore applied the 36-month average for the investment intermediation class.

Figure 4 sets out the alternative 12-month and 36-month figures. The amounts (in figure 4) are then adjusted for opening balances, management expenses and projected recoveries by funding class. The result of this is the funding requirement for the levy. The highlighted numbers are the indicative compensation amounts to be levied for in 2017/18.

Any surplus/deficit at the year-end will then form the opening balance of the calculation for 2018/19.

Figure 4: Forecast compensation costs by funding class 2017/18

Funding class	12-month forecast (£ million)	36-month historical average (£ million)	Trend (£ million)	Forecast used in levy (£ million)
Deposits (SA01)	4.20	n/a	n/a	4.20
General Insurance Provision (SB01)	128.13	112.74	n/a	128.13
General Insurance Intermediation (SB02)	14.87	13.49	n/a	14.87
Life and Pensions Intermediation (SC02)	163.32	88.07	n/a	163.32
Investment Provision (SD01)	-	2.00	n/a	2.00
Investment Intermediation (SD02)	65.80	108.28	n/a	108.28
Home Finance Intermediation (SE02)	13.27	6.98	n/a	13.27
Total	**389.59**	**331.56**	**n/a**	**434.07**

Claims assumptions

In forecasting the claims to FSCS over the next 12 months, we make certain assumptions about claims/default volumes and trends where we have sufficient information to quantify the expected numbers.

Our assumptions reflect our experience of current claims trends as well as other information from the FCA, PRA, Financial Ombudsman Service and the industry. Clearly, these assumptions may change over time. Recent years have shown that some unexpected larger failures have significantly impacted our estimates. Accordingly, we continually monitor claims trends and the prospect of firm failures and review and update assumptions, to help us determine the resources and expenses required to pay the claims we expect within target service levels.

We expect to see a slight reduction in overall claims volumes (across all sectors) during 2017/18 partially due to a forecast reduction in deposit claims received. We continue to receive high numbers of investment and life and pensions claims and anticipate increased volumes of SIPP-related claims in the coming year. In the case of investment intermediation claims there is the particular prospect of unforeseen failures at any time that FSCS needs to respond to; as evidenced in the case of Alpari (UK) Limited in 2015. We expect an overall increase in insurance intermediation claim volumes following publicity around the FCA's potential deadline of June 2019, for claims in relation to mis-sold PPI policies.

Where there continues to be volatility in claims levels, we will factor these into our assumptions as numbers become clearer. We are not currently aware of any new significant failures or other product-based trends to emerge, although we cannot rule these out.

Our assumptions about our likely future business are shown in figure 5.

2017/18

We expect to see a decline in overall claims volumes

Figure 5: Claims assumptions 2016/17 and 2017/18

Sub class	Claim type	2016/17		2017/18	
		New claims assumptions	Estimate of completed claims	New claims assumptions	Estimate of completed claims
SA01	Deposits*	10,676	9,092	6,000	6,000
SB02	Insurance Intermediation (inc PPI, but excluding Welcome Financial Services Ltd)	4,398	4,743	4,920	5,220
SC02	Life and Pensions Intermediation	5,588	6,317	7,740	8,990
SD01	Investment Provision	93	275	0	0
SD02	Investment Intermediation	6,911	9,921	6,840	7,050
SE02	Home Finance Intermediation	689	736	739	739
Total claims exc insurance payments		**28,355**	**31,083**	**26,239**	**27,999**
SB01	General Insurance Provision**	625,000	615,000	15,000	15,000

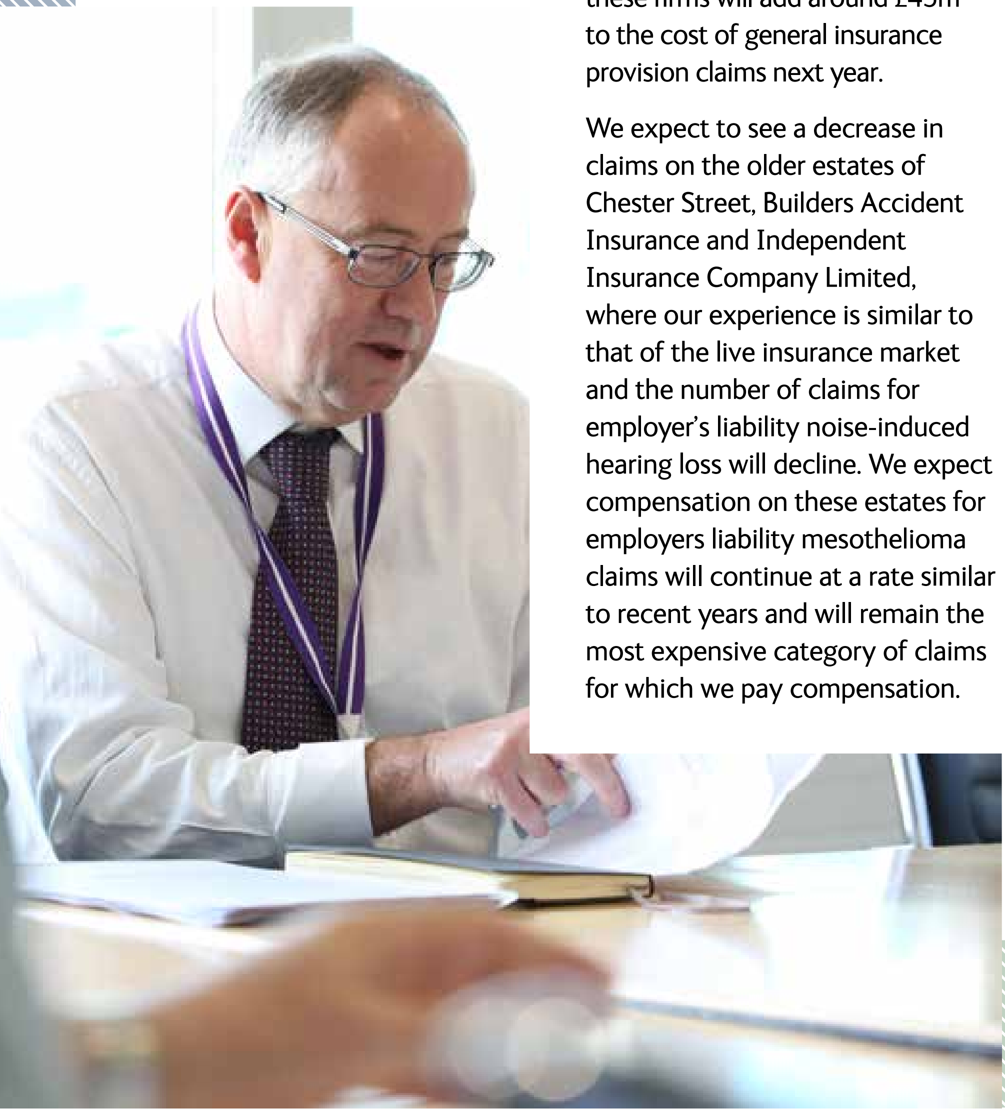
Notes:

* Excluding major bank failures.

** Including claims for return of premiums.

Deposits (SA01)

Based on our recent experience of credit union failures, we allow for a small number of credit union failures in the year ahead. Our assumptions do not provide for the failure of any other deposit taker(s) although we have in place the appropriate plans to deal with larger deposit taker failures if necessary.



General insurance provision and intermediation (SB01 & SB02)

General insurance provision

The forecast for new claims and completions in 2016/17 turned out to be an underestimate because of the failures of Enterprise Insurance in July 2016 and Gable Insurance AG in November 2016. We expect that these firms will add around £45m to the cost of general insurance provision claims next year.

We expect to see a decrease in claims on the older estates of Chester Street, Builders Accident Insurance and Independent Insurance Company Limited, where our experience is similar to that of the live insurance market and the number of claims for employer's liability noise-induced hearing loss will decline. We expect compensation on these estates for employers liability mesothelioma claims will continue at a rate similar to recent years and will remain the most expensive category of claims for which we pay compensation.

We will also continue to make payments on the recent passporting defaults of Lemma Insurance Europe Ltd (2012/13), Balva AAS, European Risks Insurance Company (2014/15) and Berliner (2015/16), although no new claims are expected next year on these estates. The majority of activity on Balva, European Risks Insurance Company and Lemma will continue to be in respect of claims arising from solicitors' professional indemnity policies. Notwithstanding the insolvencies of Enterprise and Gable, in the absence of firm intelligence of imminent (and sizable) failures, we have not made allowances for any further such failures in 2017/18 at this time.

General insurance intermediation

As in recent years, we expect PPI claims to continue to be a significant workstream for FSCS in 2017/18. Following recent falls, we are expecting to see an overall increase in PPI claims received (particularly from Claims Management Companies) during 2017/18, if any cut-off date for submitting claims is announced by the FCA.

SIPP-related
claims continue to rise

Life and pensions intermediation (SC02)

FSCS has received significant numbers of claims against independent financial advisers in relation to advice given to transfer funds from existing pension schemes to SIPPs. The majority of these claims concern advice to invest the SIPP funds in high risk, non-standard asset classes, many of which have become illiquid. These investments are often unsuitable for the majority of investors. Some investments fail.

We expect to continue to see increased numbers of claims in this category, along with other types of life and pension claims, throughout 2017/18. While there remains uncertainty as to the number and value of claims that FSCS will see going forward, we expect to see a significant increase in compensation costs because of the 'high value' nature of these claims, such that the annual limit of this class is exceeded – requiring a levy on the retail pool (to which all classes contribute). The proposed levy will reach the annual limit for this class. But given the uncertainty about the volume and value of these claims, we do not intend to trigger a levy on the retail pool immediately, but may do so later in the year when we have better insight into likely full-year compensation costs. FSCS will ensure the industry is kept up-to-date on developments.

Investment provision and investment intermediation (SD01 & SD02)

Investment provision

Although we have not made any allowances at this time, FSCS has received a number of claims against SIPP operators in relation to due diligence failings. The FCA has previously highlighted concerns in the SIPP market where operators have accepted business from non-authorised introducers. Should FSCS be satisfied that a legal liability arises and these claims are eligible, the costs in relation to these claims would come under the investment provision class.

Investment intermediation

FSCS continues to see significant volumes of investment claims against independent financial advisers in relation to negligent advice, including advice to invest in unregulated collective investment schemes. FSCS expects to see more such claims.

In recent years, the volume of these claims has been particularly hard to forecast and FSCS has to respond to unexpected failures, including in cases where firms (eg. Alpari and MFGlobal) have been placed into the Special Administration regime. Accordingly, FSCS has elected to raise levies on the basis of the 36-month rolling average in recent years as the best way of making reasonable allowance for unforeseen failures. That resulted, in 2016/17, in a substantial surplus and FSCS elected to make a partial refund of that surplus in January 2017. Nevertheless FSCS continues to take the view that the volatility and unpredictability of failures in this sector make it appropriate to use the 36-month average as the basis for the levy.

Home finance intermediation (SE02)

Although claims volumes have risen for this year and into 2017/18, this is distorted by the level of compensation forecast for claims against one particular firm which accounts for nearly 70% of the forecast costs. These are claims for advice to remortgage domestic residences to invest in high risk property schemes. Stripping out these claims reduces the level towards those experienced over recent years, so that on current evidence we would not expect this level of costs to continue into future years.

Annex 1

Management expenses budget for 2017/18, alongside the budget for 2016/17

	2016/17 Budget (£ million)	2017/18 Budget (£ million)
Continuing operations		
Staff costs	18.2	17.8
Contractor cost (non-change)	0.9	0.8
Facilities	2.5	2.9
IT	4.1	3.9
Communications	4.8	4.0
Legal & professional	2.9	3.1
External providers	0.9	0.9
Other and contingency	0.5	0.7
Subtotal core costs	**34.8**	**34.0**
Outsourced claims handling	11.6	16.1
Independent insurance contribution	(1.7)	(1.7)
Outsourced printing & scanning services	0.9	0.9
Operational total	**45.5**	**49.3**
Strategic change portfolio	10.1	9.0
Operational & investment expense total	**55.6**	**58.3**
Bank charges	6.0	5.9
Major recoveries incl PPI	2.5	2.1
Major bank failures	1.5	1.0
Total management expenses (excluding pension deficit funding)	**65.6**	**67.3**
Pension deficit funding	1.8	1.9
Total management expenses	**67.4**	**69.2**
Contingency reserve for major failure	5.3	5.3
Total management expense levy limit	**72.7**	**74.5**

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