News from the Financial Services Compensation Scheme

outlook

November 2015

Compensating consumers since 2001

CLAIMS AND COMPENSATION

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CHIEF EXECUTIVE'S STATEMENT

Mark Neale, Chief Executive

As usual, we are publishing *Outlook* in order to share with levy payers our latest assessment of the compensation costs facing FSCS. Uncertainty is an intrinsic feature of a pay-as-you-go funding system like ours. FSCS must fund legitimate compensation claims as they arise, but firm failures which give rise to those claims are not predictable or always foreseeable when we set our annual levy.

As you will see from our analysis, I'm pleased on this occasion to be able to say that we do not currently expect to have to raise a supplementary levy this year on any sector of the industry. That is the good news.

Many firms will, however, regard it as cold comfort in view of the levies they have already paid. We have, in particular, continued to see an increasing number of claims relating to self-invested personal pensions (SIPPs), which resulted in a supplementary levy in March and an increase in the final levy for 2015/16. I sympathise with advisers in the life and pensions sector who have been hit hardest by the financial impact of these claims. It underlines the importance of the Financial Conduct Authority (FCA) Review of FSCS funding in 2016 which will give a fresh opportunity to review the way these financial impacts are shared across the industry. I very much hope the industry will engage with that review. This is a zero sum game – we can redistribute, but not avoid, compensation costs – so it is very important to satisfy all stakeholders that the funding approach is fair and affordable.

We should also recognise that FSCS protection underpins consumer confidence. The levies we have raised have enabled us to compensate consumers who received negligent advice to invest their pension funds in very risky and illiquid assets. Maintaining FSCS as a safety net of last resort provides an important underpinning for an innovative advice market. We very much welcome the Financial Advice Market Review (FAMR) which is looking at how to expand the supply of financial advice following the Government's liberalisation of retirement saving. Meanwhile it remains crucial that consumers understand their options and the limits of FSCS protection. That is why FSCS is working with partners (including Pension Wise) to ensure consumers understand what the implications are for pensions protection.

This edition of Outlook also updates the industry on FSCS's own management expenses and progress with our continuing modernisation. Our focus this year has been on bedding down our new claims handling process, Connect, which went live in May. Once fully operational, the new process will enable FSCS to scale its capacity up and down more efficiently because our outsource partners, who handle the majority of claims, now share the same platform. Our customers will be able to claim and check progress online. We are already seeing claims move

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through the new process end-to-end, including claims initiated by customers through our online portal, which we are currently piloting. We do, however, have more to do to improve the application process and to accelerate workflows. Dealing with these issues is likely to lead to slightly higher than expected operational expenses in 2015/16, although we expect to offset these with savings elsewhere within an unchanged budget.

I shall report further on our progress in modernising our service in the Plan and Budget for 2016/17 to be published in January. Our Annual Report and Accounts in 2016 will summarise the results of the independent review of the delivery of the Connect project.

Meanwhile, we have made important changes to our senior structure so that it better reflects and supports our modernised service. We created the new role of Chief Operating Officer (COO) to bring together the delivery of our service to claimants with the IT and data infrastructure which supports that service. I am pleased to welcome Jimmy Barber to FSCS as our new COO. Jimmy brings a wealth of experience and will join us in the New Year. We have also created a Chief Financial Officer (CFO) role to lead our increasingly demanding financial and commercial work and I am pleased to announce that Kathryn Sherratt will take on this role. Both Jimmy and Kathryn will be members of the FSCS leadership team and (subject to PRA and FCA approval) Board. I look forward to working with them both.

LEVY UPDATE

= Lower risk   = Medium risk   = Higher risk

Funding indicators for six months to 30 September

Class	Status November 2015	Comments
Deposits (SA01)	Lower risk	Resolution of two relatively large credit unions, but no expectation of a supplementary levy
General Insurance Provision (SB01)	Lower risk	Lower compensation payments than forecast
General Insurance Intermediation (SB02)	Lower risk	Lower compensation payments than forecast
Life & Pensions Intermediation (SC02)	Lower risk	FSCS continues to receive claims, but a supplementary levy looks unlikely
Investment Intermediation (SD02)	Lower risk	Lower compensation payments than forecast
Home Finance Intermediation (SE02)	Lower risk	Lower compensation payments than forecast

Compensation Update

In our Plan and Budget 2015/16, we projected total compensation costs forward to 30 June to reflect the fact that our annual levy only becomes payable from July. In effect, the element of our levy which covers compensation costs is based on a 1 July to 30 June year. Therefore, compensation costs that arise in the first quarter of the 2016/17 financial year will be covered by the levies we raised in 2015/16.

Deposits

Deposits (SA01)	Forecast 2015/16 £m	Budget 2015/16 £m	Variance £m	Supplementary levy Indication November 2015
B/Fwd from 2014/15	4.1	13.0	8.9	
Claims	(4.7)	(10.9)	(6.2)	
Recoveries	0.1		(0.1)	
Mgmt Expenses	(16.7)	(14.5)	2.2	
Levies	12.9	13.0	0.1	
Surplus/Deficit	(4.3)	0.6	4.9	

FSCS has experienced higher than expected claims values in the deposit class in the year to date. This is because of the resolution of two relatively large credit unions – Rowallane Credit Union and The Rainbow Credit Union, in August and September respectively. FSCS does not expect this variance to require a supplementary levy.

In addition, the deposit class makes levy payments in respect of the 2008/09 legacy failures. FSCS's loan with HM Treasury in respect of Bradford & Bingley remains with an unchanged balance of £15,654m. On 1 October 2015, FSCS made a payment to HM Treasury that paid off the last of the other loans, which had been significantly reduced by recoveries, and past levies. FSCS also made an interim payment of £235m toward FSCS's liability to HM Treasury to contribute to the costs of the resolution of Dunfermline Building Society ("DBS"). Interim payments for DBS now total £335m in aggregate, plus interest.

General Insurance Provision

General Insurance Provision (SB01)	Forecast 2015/16 £m	Budget 2015/16 £m	Variance £m	Supplementary levy Indication November 2015
B/Fwd from 2014/15	50.3	44.4	(5.9)	
Claims	(101.0)	(104.1)	(3.1)	
Recoveries	2.4	5.0	2.6	
Mgmt Expenses	(4.6)	(7.2)	(2.6)	
Levies	60.2	62.0	1.8	
Surplus/Deficit	7.3	0.1	(7.2)	

There is currently a low risk of a supplementary levy in the General Insurance Provision class. Although claims volumes remain as expected, a lower than expected value of claims payments on the estates of Chester Street Insurance Holdings Ltd, Independent Insurance Company Ltd and Milburn Insurance Company Ltd have resulted in a favourable current fund balance.

General Insurance Intermediation

General Insurance Intermediation (SB02)	Forecast 2015/16 £m	Budget 2015/16 £m	Variance £m	Supplementary levy Indication November 2015
B/Fwd from 2014/15	24.7	22.5	(2.2)	●
Claims	(9.7)	(9.5)	0.2	
Recoveries	0.1		(0.1)	
Mgmt Expenses	(6.3)	(6.6)	(0.3)	
Levies	(0.1)	0.0	0.1	
Surplus/Deficit	8.7	6.4	(2.3)	

The volume of payment protection insurance (PPI) mis-selling claims continues to decline steadily.

Life and Pensions Intermediation

Life & Pensions Intermediation (SC02)	Forecast 2015/16 £m	Budget 2015/16 £m	Variance £m	Supplementary levy Indication November 2015
B/Fwd from 2014/15	5.5	1.3	(4.2)	●
Claims	(83.5)	(96.5)	(13.0)	
Recoveries	0.0		(0.0)	
Mgmt Expenses	(6.1)	(5.5)	(0.6)	
Levies	99.8	100.0	(0.2)	
Surplus/Deficit	15.7	(0.7)	(16.4)	

Since 2014 FSCS has received increasing volumes of claims against failed IFAs for negligent advice to transfer funds from existing pension funds to SIPPs. In many cases, the SIPP fund was then invested in non-standard asset classes, many of which became illiquid. In February 2015, FSCS announced that it was in a position to start compensating claimants with valid claims against IFAs for losses in the value of investments held in SIPPs. This was in addition to compensating for lost pension growth and charges taken from their SIPPs.

FSCS continues to consider the potential impact on levy payers, following the £100m raised from the Life & Pensions Intermediation sector in April 2015. FSCS expects to receive further SIPP claims throughout the rest of the financial year, both against existing firms in default and with a prospect that further IFAs who advised investors to switch to SIPPs could also fall into default. There remains uncertainty as to the number and value of the further claims FSCS will receive and process during the financial year. Therefore the ultimate amount of compensation that FSCS will pay during the year is uncertain, although at present it is considered unlikely that a supplementary levy will be required.

> “To date, FSCS has paid compensation of around £25m in relation to over 9,000 clients, and recovered £15m from Alpari’s estate.”

Investment Intermediation

Investment Intermediation (SD02)	Forecast 2015/16 £m	Budget 2015/16 £m	Variance £m	Supplementary levy Indication November 2015
B/Fwd from 2014/15	(5.1)	(15.2)	(10.1)	●
Claims	(110.9)	(123.6)	(12.7)	
Recoveries	22.3	35.3	13.0	
Mgmt Expenses	(12.8)	(12.4)	0.4	
Levies	115.8	116.0	0.2	
Surplus/Deficit	9.3	0.1	(9.2)	

FSCS has paid lower than expected amounts in the Investment Intermediation class to date, primarily due to a lower than expected volume of claims for City Equities.

In September 2015, FSCS announced that it was ready to start processing claims against failed IFAs in relation to advice to invest in tax-incentivised schemes linked to investments such as film partnerships or environmental plans. As these arrangements will typically represent Unregulated Collective Investment Schemes, FSCS can consider claims in relation to regulated investment advice. To date, FSCS has received around 150 such claims in relation to advice given by approximately 50 IFAs that are no longer trading. In light of the complex liability and quantification issues that these claims presented, FSCS sought external legal advice to help us assess these claims. We are now determining these claims on a case-by-case basis. So far we have not upheld any tax related claims.

Alpari (UK) Limited:

Following the administration of Alpari in January 2015, around 57,000 clients were owed client money. Clients were given the opportunity to claim compensation from FSCS via the Alpari ‘claims portal’, which was set up by the administrators. Following confirmation of the amount owed to each client, FSCS was able to pay compensation direct to eligible clients by electronic transfer. To date FSCS has paid compensation of around £25m in relation to over 9,000 clients, and recovered £15m from Alpari’s estate. Future claims paid by FSCS should generate dividends at no less than the current 55% rate, although under FCA’s rules we forward part of the recoveries to claimants with balances over £50,000.

Home Finance Intermediation

Home Finance Intermediation (SE02)	Forecast 2015/16 £m	Budget 2015/16 £m	Variance £m	Supplementary levy Indication November 2015
B/Fwd from 2014/15	(1.0)	(0.5)	0.5	●
Claims	(1.7)	(3.0)	(1.3)	
Recoveries	0.0		0.0	
Mgmt Expenses	(0.7)	(0.8)	(0.1)	
Levies	4.9	5.0	0.1	
Surplus/Deficit	1.5	0.7	(0.8)	

Claims numbers in this sector are broadly in line with our forecasts although there have been lower than expected claims values.

FSCS

MANAGEMENT EXPENSES

Financial summary for six months to 30 September

Management Expenses	YTD Actual £m	YTD Budget £m	2015/16 Forecast £m	2015/16 Budget £m
Continuing Operations	16.1	16.8	34.4	33.0
Outsourced Services	7.9	7.8	14.3	13.0
Total Continuing Operations	**24.0**	**24.6**	**48.7**	**46.0**
Strategic Change Portfolio	6.1	6.1	12.4	12.4
Total Operations and Investment Expense	**30.1**	**30.7**	**61.1**	**58.4**
Financing & Major Recoveries Expenses	2.3	5.4	8.0	10.7
Total Management Expenses Levy	**32.4**	**36.1**	**69.1**	**69.1**

FSCS currently forecasts that our management expenses will be within our budget for 2015/16.

- Total Continuing Operating Expenses are currently £0.6m lower than budget for the half year
- Outsourced claims handling costs are on par with the budget, although SIPPs related claims have increased, along with Alpari claims. We offset this against lower PPI and General Insurance claims.
- Strategic Change Portfolio costs are flat against the budget.
- Bank Charges have fallen because of lower bank facility arrangement fees
- Costs on major recoveries have been lower than expected, as Keydata expenses have ended.

For the full year, there is an increase in costs for Continuing Operations of £2.7m. This is a combination of additional resources required to improve workflows and processes, and outsourcing costs incurred to implement Connect. To offset this, we made savings in the Financing and Major Recoveries, mainly because of the conclusion of the Keydata recoveries litigation.

RECOVERIES

2008/09 legacy failures

FSCS continues to be active as a creditor of all the failed estates. We continue to receive dividends in respect of our claims, which have been used to reduce the borrowing that FSCS incurred with HM Treasury. We have recovered a total of £494m from these estates in the last financial year (2014/15).We have recovered a further £40m this financial year as at 30 September. Following a payment to HM Treasury on 1 October 2015, FSCS has now repaid (with interest) all of the funds borrowed for the failures of Icesave (Landsbanki) (LBI), Kaupthing Singer & Friedlander, Heritable Bank and London Scottish Bank. There should be further recoveries from these estates in the future, which will benefit levy payers.

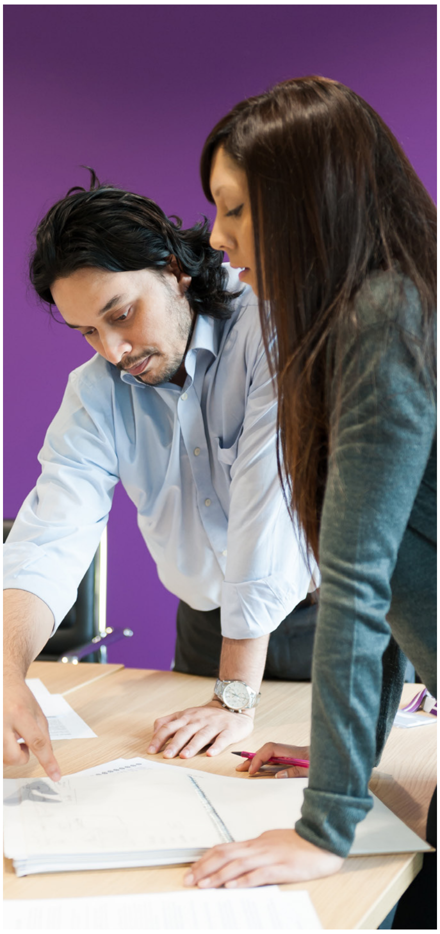
In the Icesave case, FSCS also agreed a settlement of its claim against the Icelandic Depositors and Investors Guarantee Fund. The settlement met FSCS's payout and administration costs, and released the Icelandic Krona distribution made by LBI in 2011, which had been trapped by local capital controls.

Bradford & Bingley (B&B)

The run-off of the B&B business continues, with UK Asset Resolution overseeing the business on behalf of HM Treasury. While B&B forecast repayment of the FSCS claim in full, the timing of repayment remains uncertain. We receive updates from the company on the progress of the wind down of its business.

Dunfermline Building Society

FSCS's liability to HM Treasury will not be finalised until the end of the administration, but the Scheme's last financial statements contained a provision of £448m (discounted for the time value of money) based on the latest information available at that time. This was reduced from the £552m provided the year before, largely because of the £100m interim payment made on 1 October 2014. On 1 October 2015, FSCS made a further interim payment to HM Treasury of £235m toward this liability. FSCS is also entitled to interest on the interim payments made. Since the publication of FSCS's Annual Report & Accounts 2014/15, FSCS and HM Treasury have agreed the amount of the cap to FSCS's contribution to the cost of resolution at £558m.



POLICY

Depositor Protection

On 3 July 2015, the UK implemented the Deposit Guarantee Schemes Directive. We have updated our systems and processes to accommodate the changes to FSCS eligibility and scope – and the process with counterpart EU schemes for payouts to EU branch customers. FSCS hosted five seminars on DGSD changes for Credit Unions around the UK. These proved to be very popular and well-attended events in all regions. We also published a Single Customer View (SCV) guide to assist all deposit firms in making the changes needed to meet the new formatting requirements by 1 December 2016.

The PRA announced a change to the limit of deposit protection. To ensure that the UK's limits are equivalent to the EU harmonised level of €100,000 the limit changed to £75,000. However, it remains at £85,000 for most depositors until 31 December 2015 to allow consumers to prepare for the change. In this period, deposit takers must allow customers to make withdrawals from fixed term products – to keep their deposit within the limit - without financial penalty.

HM Treasury/FCA Financial Advice Market Review (FAMR) and FSCS Funding

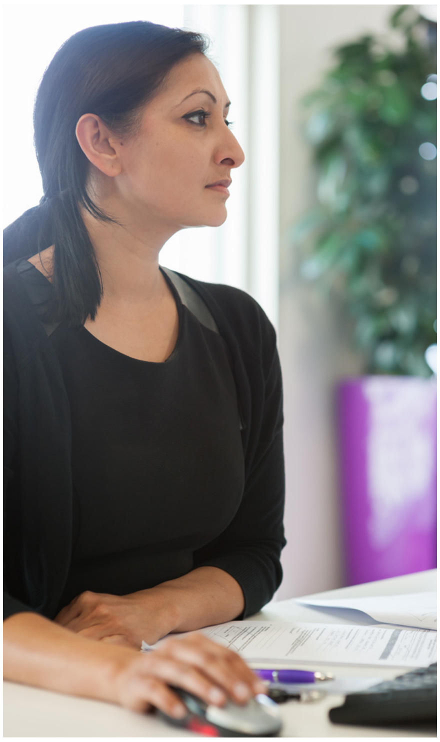
On 3 August 2015, HM Treasury launched a review, jointly led with the FCA, to examine how financial advice could work better for consumers. The scope of the FAMR is to consider the current regulatory and legal framework governing the provision of financial advice and guidance to consumers. It also considers its effectiveness in ensuring that all consumers have access to the information, advice and guidance necessary to empower them to make effective decisions about their finances. As part of FAMR, consideration will be given to the roles of FOS and FSCS, the interplay between them and with the regulatory framework.

FSCS supports the review and is already in discussions with our colleagues at HM Treasury and the FCA about the information and support we can provide.

The debate has brought in FSCS funding – which FCA is planning to review. Particular attention has been on the IFA and investment sector. FSCS is keen for a full discussion to settle the funding model, and recognises that the outcome of FAMR may impact on FSCS costs, so that the discussion needs to be carried on in parallel. Separately, the PRA will take forward the introduction of risk-based contributions in the deposit class.

National Audit Office (NAO) study

FSCS welcomed the recent announcement by the NAO that it is to review the existing systems for regulation and redress in respect of financial services mis-selling. The study will consider how the FCA, FOS and FSCS work together to detect problems and secure redress for consumers. It will also look at how the FCA regulates financial firms to counter mis-selling and consider whether the regulatory regime provides the right incentives to deter mis-selling, as well as how it identifies and responds to the risks. We have submitted information about FSCS to the NAO and look forward to working further on the issues. The report is scheduled for Spring 2016.



RAISING AWARENESS OF FSCS

We continue to build our Consumer Awareness programme, which is an evolution both in terms of look and feel, as well as how we reach our target audience. We continue to focus on the deposit protection message, and this class of levy payer solely pays for the activity.

A digital first programme, focussed on engaging content

Digital channels are becoming increasingly important for FSCS, alongside search, radio and print advertising. Since launching Phase 2 of the Consumer Awareness programme, we have grown in our experience and understanding of the best use of channels to engage with consumers. The work is highly insight driven, taking from our consumer tracking and other audience research results, to help us develop the most engaging content with the most effective targeting. We were pleased to receive the silver award for digital marketing in financial services last month for our work on the previous years campagin.

Maintaining growing awareness

In 2015/16 we continue to engage with consumers across a range of media channels to make them aware of FSCS's deposit protection. Our main audience remains men and women aged between 25-54 who own several financial products.

However, we have identified a subset of this audience - women aged 25-34 years old - who are least aware of FSCS or a protection scheme. We have developed a bespoke digital and social media programme to leverage their interest and therefore, awareness. To do this, we are focusing on the audience's key 'passion points' where money and savings are integral, such as weddings, babies, travel, décor and property.

This year, we have moved away from using celebrities to engage audiences, and instead are collaborating with peer influencers, such as vloggers, bloggers and media partnerships. This move, driven by audience insight and qualitative research, will drive engagement at a higher trusted, authentic level. You can find examples of our published work to date on our YouTube channel www.youtube.com/FSCSProtected. Follow us on Facebook, twitter, Pinterest and Instagram to find out more.

Limit change and DGSD

We are keen to ensure that consumers are aware of the new £75,000 limit. Once the new limit change was announced on 3 July, we launched bespoke campaign materials for digital, print and radio advertising, which sat alongside our existing advertising programme. Research indicates that promoting the limit change is also supporting overall awareness, particularly among those who have higher levels of savings, and are most likely to be affected by the change.

We also introduced new in branch and disclosure materials for banks, building societies and credit unions. These align with FSCS's marketing, and are now prominent in branches.

BUILDING TRUST, **INCREASING** CONFIDENCE

FSCS, in collaboration with the financial services industry, plays an essential part in reassuring consumers and instilling confidence, thereby rebuilding trust in the financial services sector. It does this both through its work in providing a compensation service, and through the variety of awareness raising activities it undertakes.

FSCS has partnered with Nick Chater, Professor of Behavioural Science at the Warwick Business School, and the research consultancy Decision Technology, to produce a paper on trust in financial services. The paper, published earlier this month, presents the findings of some new and unique research and applies the insights of behavioural science to identify the biggest "trust gaps" in the UK financial services industry.

The paper makes four recommendations on the most effective steps that can collectively be taken to restore consumer trust. The paper is available on FSCS's website. We hope you find it to be a valuable and timely contribution to the ongoing debate about the future of the industry and the role we play in increasing confidence.

Contact us:
Phone: 0800 678 1100 Email: Publications@fscs.org.uk
Please include your name and address with any messages sent