FSCS Podcast – Episode 17: Recovering the costs of compensation

0:02 – Caroline Rainbird (jingle)

Welcome to protect your money with FSCS the podcast from the Financial Services Compensation Scheme. I'm Caroline Rainbird FSCS Chief Executive. And in this series the fantastic FSCS team will help you understand how we can help to protect your money, so you can feel confident that your money is safe. Hope you enjoy the podcast!

0:34 – Farah Baldock

Welcome to Episode 17 of the FSCS Podcast. I'm Farah Baldock, from the Communications team here at FSCS, and I'll be hosting today's episode instead of our usual host, Jess Spiers. Many of our listeners will know that FSCS the Financial Services Compensation Scheme protects people and authorised financial firms go bust. We do this by paying eligible customers the compensation they're owed if they've lost money when their financial firms fail. We protect many financial products and activities, but not all of them. And on this podcast series, we aim to demystify FSCS and help you understand how we protect your money.

On today's episode, we're talking about recoveries, and we'll be taking a look at some of the work that FSCS does behind the scenes to recover the money we pay in compensation from failed firms or other third parties with responsibility for customers claims. We're joined on the podcast today by our recoveries experts from the FSCS legal team. A very warm welcome to James Darbyshire, Chief Counsel here at FSCS and also, Cecile Looseley our Head of Recoveries.

1:37 – Cecile Looseley

Hi, thanks for having us.

1:53 – James Darbyshire

Hello Farah, thanks very much for having us today, we're looking forward to talking a bit more about recoveries.

1:43 – Farah Baldock

I believe it's the first time on the podcast for both of you. And our regular listeners will know that we always ask our new podcast guests our traditional closing question. So just to pre warn you, I will be asking this at the end of the episode. So you can have a little bit of a think about your answers in advance. FSCS is all about protecting your money but which toy would have had you breaking open your piggy bank as a child? Just something to have a little think about.

2:18 – Farah Baldock

So, let's get started. Some of you may be wondering, what is a recovery? And what's it got to do with my money? James, Cecile, could you shed some light on this for us?

2:28 – James Darbyshire

Sure. Yes. I mean, FSCS is primarily known for paying compensation to customers when firms go bust. And certainly if you bring a claim to FSCS, you might think that well, that's the end of the journey, certainly for our customers, that's usually true. But for us, actually, it can be the beginning of another long journey in terms of pursuing recoveries, which is one of the other main functions that FSCS performs. So in terms of what a recovery is, it's essentially a legal claim that we pursue to try and recover the costs of compensation that we paid to customers. And we do that normally, in a couple of ways. We either pursue claims against the failed firms, or it could be against any other party who had some involvement in whatever was being sold to the customer in the first place.

So basically, we're looking at a way of recouping those costs from people who were involved and somehow have a legal liability that we can go after. I mean, I guess in terms of what's the kind of tests that we use, it's really a commercial test. So if we think it's cost effective, and it's a claim that is reasonably possible, then that's something that we would pursue perhaps Cecile, you could tell us a little bit more about how we pursue a recovery.

3:39 – Cecile Looseley

Yeah that's right. It is a commercial test. And just to be clear, we don't see recoveries to make a point or to punish wrongdoers, we do focus our efforts on where we can get some money back. So when a customer makes a successful compensation claim to FSCS, their rights in relation to that claim is transferred to us. And as James said, that relates to the rights against the firm and default, or any third parties that might also be liable for the losses suffered by that customer. So this effectively means that FSCS stand in the shoes of the customer.

So in the case of a failed firm, that would make us a creditor of the firm, and would allow us to pursue recoveries against the firm in its insolvency, if appropriate. And I should point out as well that we pursue the whole amount of the customer's loss, not just the amount of compensation we've paid. So in some cases, their losses might be capped by our compensation limit, but we look to pursue the whole amount, and the reason for that we'll go into in a bit more detail a bit later. But we look at a variety of ways of pursuing recoveries beyond the claim and the insolvency, we might pursue litigation proceedings against the parties that might have caused losses. We'll also look at whether we can make a claim to the firm's professional indemnity insurer. That's a requirement that all regulated firms have in order to be authorised.

So where we can, we will make a claim on that insurance policy as well, or through a variety of other dispute resolution processes. And also where we've treated specific investments as having no value in the hands of the customer, because the returns on them so uncertain or possibly so far in the future, and we've treated that as being fully compensated for the customer. We'll also look at whether we can make a recovery on those investments as well.

5:31 – Farah Baldock

Brilliant. Thanks, Cecile. Actually, I just wanted to pick up on something you mentioned, we see this recoveries once a firm has defaulted has gone into default, would either one of you be able to just let us know a little bit more about what we mean by that? What does it mean by a firm going into default?

5:46 – James Darbyshire

Sure. A firm goes into default, that's really something that we do ourselves. So we declare a firm in default, essentially, if there are two kinds of elements needed. One is that the firm has gone bust or is in some other way not able to pay compensation due, but there also has to be at least one protected claim against that firm. And that combination of those two things trigger FSCS protection. And so we will then make a publication of that default. And the way we do that will kind of depend on how widespread or how the systemic issue is affecting that firm. So we might just put something on our website, or if it's a bit broader, and we want to target particular areas, we might use local press and things like that.

6:23 – Farah Baldock

Excellent. And also you reminded us that FSCS pays customers compensation when those firms fail. But where does the money come from for compensation, if the firm's themselves that owe the money to customers have actually gone bust?

6:37 – James Darbyshire

Well, the reason we can pay compensation in the way we do is thanks to an annual levy that we charge to regulated firms. So financial services firms that are regulated either by the FCA or the PRA. And that levy funds both the running of FSCS as an organisation but also, most importantly, it funds the costs of compensation and enables us to process claims. So essentially, you have a system which is kind of the good paying for the bad in the sense that customers are not left high and dry, when a firm that's caused them loss goes bust. But the rest of the industry essentially comes together and shoulders that burden, which otherwise the customer would be left to fund themselves.

And I guess that's particularly important for a lot of our customers, because they're often left very vulnerable, they've been mis sold, let's say a pension or some other life saving. And obviously, that can have a very significant impact. It's not something they would have been expecting or anticipating so the fact that FSCS can step in and to do so quickly is kind of incredibly important and then we can put those customers back on track. So I guess FSCS really acts as a safety net more generally, and reassuring both consumers who've not actually come to us yet or at all.

And certainly, those who actually have to come to us as customers, reassuring them, I guess that their money is safe when they go about buying financial products and services. And in that way, FSCS helps provide financial stability, and raises confidence and trust in the financial services industry as a whole.

8:18 – Farah Baldock

That'll make sense. And where does recoveries fit into all of this?

8:21 – Cecile Looseley

Well, paying compensation to the customers is just one part of the picture. So alongside our obligations to customers, we also have a duty to our levy payers, and that is to ensure that the levy is fair and balanced. So reducing the levy in a sustainable way for the industry is a priority for FSCS. And one of the ways in which we do this is through our recoveries work.

So I'm really pleased to say that since 2015, FSCS has recovered around 290 million pounds from failed firms and other third parties. And as we're a non-profit organisation, the funds we recover are always put back into running our service and paying compensation to customers. So this is done by way of reducing the levy going forward for the industry. And we know that the majority of financial firms behave responsibly towards customers and so it's through this recoveries process that we can better hold the bad actors out there in the system to account.

9:19 – Farah Baldock

Oh, that's great for levy payers, and does the money we recover ever make its way back to the customers who were harmed in the first place?

9:26 – Cecile Looseley

Yeah, absolutely. So when we make a successful recovery, we also have an obligation to ensure that the customer is no worse off for having come to FSCS first and made a prompt claim for compensation. So that means that where possible funds that we've secured from recoveries can be used to top up compensation for customers who may have lost more than what we were able to pay them due to the rules around our compensation limit. So we call this process the payment of a distribution of surplus.

So just last year, for example, we were able to pay out about 3 million pounds to another 170 customers through this distribution of surplus process. And a great example of this is on I'm not sure I can say the name, but on a particularly dodgy holiday resort development that many customers bought into, one customer in particular had losses of over £315,000. And our compensation limit at the time was £50,000. So he was only able to get £50,000 from us through compensation. But as part of our recovery work, we pursued a breach of trust claim against the trustee of that development, and we're able to secure a settlement. And for that particular customer, we could pay him an additional nearly £73,000 of distribution from our recovery work.

So that's great news for this customer who wasn't expecting this money, and not that we don't have thanks, but we received an absolutely lovely email from him telling us just how much this meant to him. And what a surprise it was, and thanking us for all our hard work on this. So that always makes our day when we get messages like that from customers.

11:03 – Farah Baldock

Brilliant, that's really great to hear. Also just picking up on an earlier point about how we want to put customers back on track, and also the fact that you know, we are paying out that compensation to customers directly. Why is it that FSCS pursues these recoveries instead of customers? Why don't the customers go direct to the organisations or other third parties that might have a responsibility to their claim?

11:31 – James Darbyshire

Well, I guess the main thing is that pursuing recoveries can be very complex, we're often now having to see recoveries in many different jurisdictions, and not even just the UK. And you wouldn't necessarily think that when you're talking about FSCS, and as the UK’s compensation scheme, but we are pursuing recoveries all over the world now, normally connected to various weird and wonderful investments that people have been badly advised to invest in, often through their pensions.

And also pursuing recoveries can just take years, where FSCS also can bring recoveries together. So we have a kind of, you know, ability to bring a much bigger claim against institutions rather than customers having to do it individually. And obviously, customers don't have the same financial resources or technical know-how and experience that we do. And the whole point of FSCS is really to encourage customers to be able to use a free service and go to FSCS and claim compensation first, and then as it were handed over to FSCS to do the recovery work.

12:31 – Farah Baldock

Absolutely. And if they claim with us directly, like you say, it's completely free for them.

12:36 – James Darbyshire

Yeah, so customers can come and bring a claim directly through our website. And as Cecile was mentioning, when customers do bring their claim for compensation to FSCS, part of the deal of getting compensation from FSCS is that they agree to transfer their legal rights to FSCS, once compensation is paid, and then that allows FSCS to then pursue a recovery claim against whichever parties we think potentially responsible for those losses. And if the total value of compensation is very high, and we've assessed that pursuing a recovery is reasonably possible and cost effective, then we will go ahead and pursue those recoveries instead of the customers.

13:15 – Farah Baldock

Right so it's interesting to hear how recoveries actually helps to reduce the levy and also supports customers who may have lost more money than FSCS was able to pay them in compensation. But can you also tell us any more about why recoveries can be so complex? I know Cecile you started talking about a couple of examples there was there any more that you could say about that?

13:35 – Cecile Looseley

Yeah, sure. I mean, as we said before, when we pursue a recovery action, when we decide to pursue recovery action, we'll assess the likelihood of success and whether it's cost effective. So if we'll get back more than what we're likely to spend in doing that. So often, a lot of work has to be done upfront to make that decision. So there'll be some cases where, you know, after investigation, we decide we can't pursue those recoveries. And this is written into our compensation rules as set out by the FCA and the PRA.

Part of the reason we can't pursue them all is because of the complexity and then it does take up quite a lot of resource. And as James mentioned, it could take many, many years as well. But within the FSCS, our recoveries team worked closely with the operations team and our finance team to gather data and the evidence needed to support this recovery work and will also collaborate with other agencies such as the FCA, the Serious Fraud Office, the Insolvency Service, and naturally will also work closely with the relevant insolvency practitioners such as liquidators or administrators who have been appointed to the firms in default or the underlying assets that customers have bought into.

Again, as James mentioned, we're often having to liaise with agencies in international jurisdictions, and in these cases, the regulations and often the legislation will be different to that of the UK. So there's sometimes a bit of a learning curve for the team, as well, to get to grips with all of those.

15:03 – Farah Baldock

Do you have any examples that you could share with us?

15:06 – Cecile Looseley

In terms of examples, we have pursued a number of high profile, high value and very complex recoveries actions. And these relate to just from range of investments such as these holiday resorts who have got some farmland in Australia, various forestry projects. And I was thinking actually a good example of a really complex and long running recovery action is the Harlequin matter. I wondered if James might be able to tell us a bit about that on considering how many years he's been working on that one.

15:37 – James Darbyshire

Yeah certainly, it's been going on for since about 2014 now, so this was a scenario where I guess customers were investing often their pension, certainly large sums of money, and sometimes their life savings through independent financial advisors, or through SIPP operators into an investment where they thought at least anyway, they were investing in holiday properties across the Caribbean, various different locations across the Caribbean. And certainly FSCS has declared a lot of firms in default as a result of the bad advice that happened there so I think since 2014, we've probably declared about 110 firms that are connected to Harlequin.

But basically, Harlequin was the brainchild of a guy called David Ames. And really, it turned out that this was just a giant Ponzi scheme. And Mr. Ames was subsequently prosecuted and convicted by the Serious Fraud Office and in fact, he was sentenced to 12 years in prison as a result of his role in this. And in terms of the kind of ongoing recovery of work that we've been doing. I mean, part and parcel actually, of that work has been to share what we found out. So our data and insights with the SFO, so it allowed them to help them in their prosecution of David Ames.

But we've also been pursuing recoveries through the insolvencies of the various holiday developments across the Caribbean. So we've been learning a lot about Caribbean insolvency processes over the last few years. But that's an ongoing process, we paid out I think, in relation to Harlequin, about 3,000 customers, and we paid out over 150 million pounds. So it's clearly made a big impact on those customers and trying to help them back on track. But the recoveries work is obviously looking now to help the position from the levy payer side of the equation. And so that's something we're going to be pursuing actively for a while yes, I suppose. Are there any other examples Cecile that you thought would be good ones?

17:31 – Cecile Looseley

Yeah, thanks. Another great example, and which you may have read about recently, or over the last year or so in the press is the German Property Group, which is also known as the Dolphin investment. And this was an investment scheme through several vehicles, which were focused on redeveloping derelict properties in Germany, and then on sold for a profit, which would generate the returns supposedly to investors. Unfortunately, this also turned out to be a massive Ponzi scheme. And the German public prosecutor is investigating the actions of the various companies and their directors as well. You know, investors from the UK alone are thought to have lost in excess of 200 million pounds.

So this is a really significant failure for many, many people. And so from October 22, we'd compensated customers who had invested upwards of £61 million pounds in the Dolphin investments. And we're working really closely with the IP in Germany, there's also a UK company that issued bonds that then passed on monies into the German companies. So we've put in claims in those estates as well. And we're working really hard with various insolvency practitioners to get some money back for all these poor investors, poor customers, really. Another one, James, I thought was really good, really interesting although it's been a few years, it was the key data litigation as well. And I thought that was a good example where we've done something a bit unusual, a bit not so straightforward. So key data itself was essentially an investment product.

But what was unusual is it was regulated so it was declared as a firm in default, essentially, that where we pursued the recovery was in relation to hundreds of IFAs that recommended the key data product. So these are all live IFAs, that were still trading. And we brought in a group action on behalf of all the customers in key data that we paid and pursued the various IFAs through the courts. So what was it, 800 IFAs we started proceedings against?

19:36 – James Darbyshire

Yes, I think that's right. And it was a very big and complicated piece of litigation so what we did was also made use of our panel law firms to help us which we do in recoveries, sometimes some of these more complicated ones. And so one of our panel for law firms at the time, Herbert Smith, were engaged to help us pursue that recovery. And actually, it resulted in us getting in recoveries of just over £50 million. So it was very successful.

20:00 – Farah Baldock

You mentioned to sale that it was a group action that you pursued in relation to key data. Can you just explain a little bit of what is a group action?

20:08 – Cecile Looseley

Oh, sure. What that means was we had those 800 IFAs listed as defendants in the one claim rather than bringing 800 separate claims. So it meant that we could collate all the claims all the investors, a lot of them, the underlying issues, the basis of the claim in negligence were the same. So we could group it that way and conduct the litigation in a much more cost effective way.

20:32– Farah Baldock

All right, I see. Well, it does sound like it must have been quite a lot of work going on in the background to try and pull all of that together and bringing all of the different parties together in order to pursue that. Were there any other examples or things like that, that you might want to highlight?

20:48 – James Darbyshire

One other good example, actually, of the kind of importance of the recoveries where it was the recovery, we did in relation to the financial crisis going back in 2008. So obviously, those were very extraordinary times and in fact, FSCS, not long after the collapse of Lehman Brothers in September 2008, other banks with retail customers started to fail. And we were triggered and in fact, over the period over about, I think, three or four months, we paid out nearly £21 billion in compensations, which was obviously pretty extraordinary meant we had to borrow that money from the government to be able to pay that money out. And obviously put those customers back on track at a very volatile time.

But it also then started the process of pursuing recoveries so a lot of these recoveries are essentially claims in the insolvency of these banks, which were largely UK banks, but sometimes they were UK subsidiaries of Icelandic banks, you may remember, there was an Internet bank called Icesave which was one of the banks that failed, which was the UK version of lands banking, which was an Icelandic bank. And we developed a claims process that use the Icesave website to be able to pay money back through people's login details for Icesave.

Anyway, we in terms of recoveries, we pursued claims in the insolvencies of these banks and in fact, the final dividend came through on one of those insolvencies in 2020. So over a decade later, and we've recovered just over £20 billion in recoveries. So the difference actually, ultimately being the interest that was paid on the loan that we've got from the government in the first place. So it was a very successful recovery, and obviously a very important one for all levy payers.

22:26 – Farah Baldock

Absolutely. And well, a decade long recovery process, that's quite impressive and I can see how it really kind of shows how complex these actions can be. And it sounds like there's a lot of work going on behind the scenes of a failure to recover from those compensation costs. And it may be that we'll have to revisit some of these again in future episodes. Before we wrap up, James, Cecile, are there any other final messages you'd like to share with our listeners about FSCS’s recoveries work?

22:55 – Cecile Looseley

Yeah, I mean, as we've talked about, over the last sort of few minutes perusing recoveries can be very complex and take many years to complete. So while there is a possibility that recoveries can support customers through the distribution of surplus process, it's important to remember that due to the nature of the work, it won't always be the outcome for all customers who may have lost more than were able to pay in compensation.

But it's important that customers understand if and how their money is protected. So we've got lots of resources on the FSCS website that can help them to understand what we do what's protected, and lots of tools they can use to check the status of their position.

23:37 – Farah Baldock

Yes, that's right. And just a reminder to our listeners, that you can find those tools on our website at fscs.org.uk/check. So I think that's about all we have time for today. I just like to thank James and Cecile, for joining us today. I know it's your first time on the podcast, and it's brilliant to have you on the show and to hear about what is perhaps a less well known area of our work.

So thank you very much for joining us today and just going back to our traditional closing question. FSCS is all about protecting your money, but which toy would have had you breaking open your piggy bank has a child? I hope you've both got some good answers for us on that one. James, how about you? Which toy would have had you breaking open your piggy bank as a child?

24:23 – James Darbyshire

Well, I'm in danger of showing my age I think by telling you what my toy is. But I think the toy I'd go for is subbuteo if either of you remember that which was the table football kind of games, which I think came out in like the 60s and I feel like that but it was kind of like you have little kind of miniature people that you flick towards the ball to kind of recreate a football match. You normally managed to break most of the players pretty quickly. So most of my teams were down to about four or five people very early on in their life but it was good fun.

24:52 – Farah Baldock

Yes I do remember those, yeah, kind of early version of your table football without the bits on the side to move your pieces around and how about yourself, Cecile?

25:01 – Cecile Looseley

Well, I probably wouldn't have broken my piggy bank or would have just, you know, pinched money from my brother's piggy bank. But if I did have to break mine, there was a doll that I absolutely loved called a Hugga Bunch. I'm not sure if you guys had them in the UK, I grew up in Australia, but it just a little girl's doll to a nice round face with a little button nose and curly hair and they all had different names and you'd get an adoption certificate in the box, and I would have gone for one of those I think.

25:32 – Farah Baldock

I don't think I've heard of a Hugga Bunch. But that sounds great and with official documentation as well.

25:39 – Cecile Looseley

You could probably find them on eBay now at a much-inflated price.

25:43 – Farah Baldock

Probably yes. Okay, well, thank you very much. And I hope you've all enjoyed listening to our episode today. Thank you very much to our listeners for tuning in. And you'll find all of our podcasts on the FSCS website at fscs.org.uk as well as all the usual places you would find your podcasts etc. So yeah, if you wanted to listen to any of our other podcasts and find out a bit more about FSCS and how we protect your money, do tune in to some of the other episodes.