outlook

fscs

News from the Financial Services Compensation Scheme | December 2019

Compensating consumers since 2001

FSCS UPDATE

- Chief Executive's Statement

LATEST POSITION

- Funding indicators by sector
- Levy Forecast
- Management Expenses

ALSO IN THIS ISSUE

- Recoveries: KSF
- Case Studies: British Steel Pension Scheme; East London Credit Union; and Alpha Insurance

CHIEF EXECUTIVE'S STATEMENT

Caroline Rainbird, Chief Executive

> To protect vulnerable customers, robust procedures are in place to ensure they are supported throughout all stages of their claim.

Welcome to my first edition of Outlook, one of four regular FSCS publications. It is about seven months since I joined FSCS and I write this with a real feeling of belonging and a commitment to our shared vision. It is an honour to lead an organisation that makes a genuine difference to consumers lives and the way the financial services sector is regarded.

I am pleased to report that we have seen good progress in delivering our vision for the 2020s – Protecting the Future. This strategy was a key reason I applied for the role of Chief Executive Officer as I wanted to be able to contribute my experience and expertise to its delivery. The strategy focusses on four pillars:

Prepare - to ensure that we are prepared for a wide range of possible failures across the sector.

Protect - to protect our customers and get them back on track when failure occurs.

Promote - to promote awareness of FSCS protection.

Prevent - to work with industry and regulators to help prevent future failures.

I continue to be impressed with my colleagues' work, and the way it embodies the ambitions set out in the four pillars. They are committed to delivering the best service to protect customers and rebuild confidence in the financial services industry, and they are equally driven by the need to provide an effective and efficient service to ensure value for money for levy payers.

Customers are at the heart of our work and it is perhaps the claims handlers who most experience how fragile customers are after financial loss. Claims handlers must follow established processes to deal with claims as efficiently as possible, but as 90% of our customers are classed as vulnerable, claims handlers also know the importance of empathy. To protect vulnerable customers, robust procedures are in place to ensure they are supported throughout all stages of their claim.

As you do not often hear of the 'human' side of the levy, I would like to share a testimony from a vulnerable customer. They were not a sophisticated investor, but someone who had everything to lose, and thought they had after they were wrongly advised to transfer their pension into a SIPP.

At the time they told us: 'The amount in the fund was £50,000, which is a lot for me as I'm not a high earner and I managed to save it into my pension over a number of years. Now the worry that I've lost it has added to my health conditions.' As soon as the claims handler heard that the customer was vulnerable, we were able to accelerate the claim and FSCS paid £50,000 in compensation within two months. The customer told us they felt that FSCS was very supportive. This testimony demonstrates the impact of our work, as FSCS, levy payers and our regulatory partners all have the consumers' best interests at heart.

Working closely with Capita, our outsource partner, we have reduced the time taken to handle claims, increasing not just customer satisfaction but importantly helping to provide reassurance in the financial services industry. On average claims take 137 days, although as we have seen with recent SIPP payments, many claims are completed in less than three months.

I am deeply conscious that without levy payers funding and support we cannot expect to meet our goals. Since joining FSCS in May, I have spent time meeting firms and trade bodies to hear views on the operation of FSCS and our funding. I am pleased to hear that the industry acknowledges the vital role FSCS plays in helping to protect the customer and support market confidence and financial stability and accepts its role as our funder. But I recognise the concerns about the rising trends in compensation costs. It is key for us to work together to reduce compensation – avoiding consumer detriment and costs to the industry.

We have a common interest in a successful financial services market, which must include FSCS when the worst happens, and firms fail. Our work continues to make the public at large aware of our protection, and to achieve this we need to work in partnership with the industry and use industry experience and insights to avoid repeated customer harm and to reduce future levies.

The Prevent pillar of our strategy is core to our relationship with industry. With regulatory colleagues we have set up the anti-phoenixing working group, and FSCS has contributed additional data and intelligence to the FCA authorisations processes for firms, including Claims Management Companies (CMCs). We are currently setting up the first industry panels to 'horizon scan' for issues that FSCS might have to deal with and, if so, help us to think about how these might be mitigated or avoided. We are also working with our regulatory partners to share our data and intelligence more broadly and effectively. We know that this is welcomed by the industry and is already starting to bear fruit, even if its full impact will take a little time.

In the first half of this year we have seen a steady increase in investment sector claims, in particular for pensions related advice, which will mean additional costs for firms in the Life Distribution, Pensions and Investment Intermediation class, and the Investment Provision class. The table on p4 shows the level of likelihood of a supplementary levy this year. These are early predictions and a more definitive announcement will be made in the new year. There may also be a call for additional funds from the investment provision class to meet SIPP related claims, following a series of operator failures, however this is less certain.

With regard to London Capital & Finance (LCF) there is not yet anything definitive to report as, working closely with the FCA and the administrators, we continue to investigate this complex matter. At the present time we cannot say what impact this may have upon levy numbers. We are keeping LCF customers updated and will of course keep you informed with our progress.

Through our vision for the 2020s, we continue to work closely with regulators to tackle the matter of pension mis-selling. One positive outcome which demonstrates commitment to our strategy and shows the benefits of collaborative working, were the visits FSCS, FCA, MaPS, FOS and The Pensions Regulator (TPR) made to Port Talbot to meet British Steel workers. During these meetings we were able to explain to British Steel workers how we could help them, and we discovered that many wrongly believed they did not have a right to compensation. You can read more about this on p10.

I look forward to leading FSCS into the future and working with you to achieve our vision for the 2020s. ■

LEVY UPDATE
FUNDING INDICATORS BY SECTORS

2019/20 Funding indicators by sectors

Funding Class	Indicator	Commentary
Deposits	GREEN	A forecasted class surplus has arisen due to recoveries received. A levy repayment is likely.
General Insurance Provision	GREEN	A forecasted surplus has arisen as a result of lower compensation than expected. A levy repayment is unlikely.
General Insurance Distribution	GREEN	A small deficit is expected. A supplementary levy is unlikely.
Life Distribution, Pensions and Investment Intermediation	RED	A supplementary levy is expected following increased claims volumes and new defaults (for example, SVS Securities). Any additional levy would be partly funded by the Investment (15%), Life (11%) and Structured Deposits (1.5%) provider classes.
Investment Provision	AMBER	A deficit of £14m is forecasted, following more Beaufort Securities and SIPP operator claims. A supplementary levy is possible.
Home Finance Intermediation	GREEN	Lower compensation costs than expected are forecast. No levy or refund expected.

Funding indicators

Classes

- GREEN - Low risk of supplementary levy
- AMBER - Medium risk of supplementary levy
- RED - High risk of supplementary levy

LEVY FORECAST CLASS TABLES

Deposits

2019/20 Forecast (12mths)	October Forecast (£m)	April Outlook (£m)	October vs April (£m)
Opening balance	9.09	(2.33)	11.42
Compensation	(6.32)	(5.38)	(0.95)
Recoveries	28.07	6.00	22.07
Management Expenses	(12.69)	(12.62)	(0.06)
Annual levy receipts	15.90	16.00	(0.10)
Closing Surplus/(Deficit)	**34.04**	**1.67**	**32.37**

Deposits

There have been six credit union failures so far this year, including East London Credit Union which had over 5,000 customers (the largest by number to date). The forecasted cost of compensation is only marginally above the original forecast when the levy was set. We have sold the residual claim in the insolvency of Kaupthing Singer & Friedlander Limited, which has realised a recovery of £15m (p.9). We have also seen some unexpected additional levy receipts from prior years. In summary there is now an expected surplus in this class of £34m and so it is likely there will be a refund to levy payers.

General Insurance Provision

2019/20 Forecast (12mths)	October Forecast (£m)	April Outlook (£m)	October vs April (£m)
Opening balance	24.92	24.53	0.39
Compensation	(162.54)	(179.22)	16.68
Recoveries	2.37	1.20	1.17
Management Expenses	(6.26)	(7.43)	1.17
Annual levy receipts	161.07	162.00	(0.93)
Closing Surplus/(Deficit)	**19.56**	**1.09**	**18.48**

General Insurance Provision

There were two new failures this year, LAMP Insurance, which is expected to generate an additional £5m cost this financial year and Elite Insurance. Elite went into administration on 11 December, and we are in the process of identifying how many UK customers are affected - we are not yet able to confirm the additional cost from its failure. As a result of lower claims costs, £17m lower than originally expected across multiple estates (in particular Enterprise, Gable and Chester Street), there is presently a surplus of £20 million. There is a risk that some large claims will fall in this financial year and, following the failure of Elite, we do not expect to refund this surplus.

General Insurance Distribution

2019/20 Forecast (12mths)	October Forecast (£m)	April Outlook (£m)	October vs April (£m)
Opening balance	3.77	3.65	0.12
Compensation	(12.46)	(10.60)	(1.87)
Recoveries	0.00	0.00	0.00
Management Expenses	(7.68)	(7.96)	0.28
Annual levy receipts	15.62	16.00	(0.38)
Closing Surplus/(Deficit)	**(0.75)**	**1.09**	**(1.84)**

General Insurance Distribution

The final stage of the FCA's PPI deadline campaign ran to 29th August across TV, radio, out of home (billboards) and digital channels. The media interest in the PPI deadline in August generated additional claims and so we now expect to make 40% more decisions than originally forecast. However, many of these claims appear more speculative and we expect a lower uphold rate so that the forecast cost of compensation is only £2m (18%) more. A supplementary levy in this class is not expected and the deficit, currently forecasted to be £1m, will be added onto next year's levy.

Life Distribution, Pensions and Investment Intermediation

2019/20 Forecast (12mths)	October Forecast (£m)	April Outlook (£m)	October vs April (£m)
Opening balance	(11.61)	(10.28)	(1.32)
Compensation	(237.44)	(193.32)	(44.12)
Recoveries	14.94	10.41	4.53
Management Expenses	(22.08)	(17.35)	(4.72)
Annual levy receipts	210.02	211.00	(0.98)
Closing Surplus/(Deficit)	**(46.17)**	**0.45**	**(46.61)**

Life Distribution, Pensions and Investment Intermediation

We expect to raise a supplementary levy and forecast £46m will be needed from the class (including the provider contribution). We have now seen an increase in expected compensation in this class of £44m (23%) compared to the levy forecast. The main area of claims, £162m of total costs of £237m, is in relation to pension advice. We have experienced more complex, and more expensive claims in this area and this has increased the cost by £20m. We also expect to make 1,200 (58%) more decisions in relation to general investment activities against a variety of firms. As we are likely to have to deal with claims from the recent failures of SVS Securities and Reyker Capital, there is an allowance for this increase and we will update in the new year.

Investment Provision

2019/20 Forecast (12mths)	October Forecast (£m)	April Outlook (£m)	October vs April (£m)
Opening balance	22.83	15.10	7.73
Compensation	(131.01)	(113.97)	(17.04)
Recoveries	(0.01)	0.00	(0.01)
Management Expenses	(5.84)	(0.60)	(5.24)
Annual levy receipts	99.97	101.00	(1.03)
Closing Surplus/(Deficit)	**(14.05)**	**1.52**	**(15.57)**

Investment Provision

There are two main categories of compensation cost on this class. First, there are costs in association with Beaufort Securities, for negligent discretionary fund management that are greater in volume, but lower in average compensation value. Second, we also expect to fund approximately 500 additional claims this year in respect of SIPP operators following the recent failures of Lifetime SIPP, Guardian and Berkeley Burke. As such, a supplementary levy is a possibility. We are keeping this under review and will announce an update in the new year.

Home Finance Intermediation

2019/20 Forecast (12mths)	October Forecast (£m)	April Outlook (£m)	October vs April (£m)
Opening balance	8.83	8.83	0.00
Compensation	(5.09)	(12.05)	6.96
Recoveries	0.05	0.00	0.05
Management Expenses	(2.00)	(1.58)	(0.42)
Annual levy receipts	4.99	5.00	(0.01)
Closing Surplus/(Deficit)	**6.78**	**0.19**	**6.58**

Home Finance Intermediation

Although we have received more claims than expected, the proportion of upheld claims has dropped, so there is currently a surplus forecasted of £7m, which will be carried forward. ■

RECOVERIES
SALE OF FSCS'S CLAIM IN KSF

The sale of our remaining claim in the UK bank, Kaupthing Singer & Friedlander Limited (KSF), in August 2019 for £17.8 million, which includes £2.8m recovered on behalf of HMT, marked the end of FSCS interest in this bank.

> "KSF failed in 2008 leading to FSCS paying out just under £3.1 billion in compensation to around 160,000 customers of KSF."

KSF failed in 2008 leading to FSCS paying out just under £3.1 billion in compensation to around 160,000 customers of KSF. This was largely achieved through FSCS funding the transfer of the deposit book to ING Direct, but it also involved paying compensation to individual depositors, charities, universities and local authorities.

The payout was funded by HM Treasury (HMT) for amounts above FSCS's limit. FSCS had received dividends of 86.15p in the pound, a total of £2,660 million.

The decision for FSCS to realise cash through the sale of the residual KSF claim in 2019, rather than wait for (potentially) several years until the administration concluded, was made in conjunction with HMT. It was determined that to do so would be in the best interests of FSCS, HMT and our levy payers. ■

TAKING ACTION
BRITISH STEEL PENSION SCHEME (BSPS)

Pictured: Simon Wilson, FSCS Resolution Manager, addresses steelworkers.

During August and September 2019, FSCS attended four outreach sessions in Port Talbot for steelworkers, which were organised by the FCA and also attended by FOS, the MaPs and TPR (pictured above).

FSCS staff spoke to steelworkers to answer their questions about possible claims and examine their individual cases. The team was able to provide valuable face to face guidance, often one-to-one, on individual circumstances, amidst the understandable angst and confusion that steelworkers felt.

The Port Talbot Steelworks is the largest steel plant in the UK, employing over 4,000 people.

In late 2017 members of the existing BSPS were presented with the option of transferring into a new British Steel Pension Scheme (BSPS2), remaining in the existing scheme, thereby ending up in the Pension Protection Fund (PPF), or transferring out of the scheme altogether.

In total, almost 83,000 members of BSPS, from a total of 130,000, chose to move into BSPS2. Some 39,000 members ended up in the PPF because they did not express a choice or because they chose to do so. Of the 44,000 members who were entitled to a Cash Equivalent Transfer Value, around 8,000 transferred their benefits away from the defined benefit (DB) BSPS.

Advice to transfer out was given, even though the FCA had stated earlier that same year (June 2017) that historically transferring out of a DB scheme has been unlikely to be in the consumer's best interests.

Various members were advised by Active Wealth to transfer out of BSPS and into private pension arrangements, including into self-invested pension plans (SIPPs).

In January 2019, an independent report, commissioned by The Pensions Regulator (TPR) and authored by Caroline Rookes, former CEO of the Money Advice Service and before that Director of Private Pensions at the Department for Work and Pensions (DWP), found that the steelworkers had been misinformed, received poor advice and were sitting targets for unscrupulous advisers.

FSCS became involved in February 2018 when Active Wealth entered creditors' voluntary liquidation, and FSCS subsequently declared the firm in default on 26 March 2018.

FSCS has to date received 86 claims against Active Wealth from British Steel workers who were advised to transfer their pension into SIPPs holding other investments. Of these, 74 have been upheld, with the remaining 12 not being eligible for compensation as no loss had been experienced.

The total compensation FSCS has paid to steelworkers is £2.4m, an average of just over £32,400 per claimant.

Following discussions with the steelworkers' representatives, MPs and the FCA, we reviewed and recalculated some of the claims and amended our procedures for the calculation of losses. Those discussions, the legal issues and operational processes were challenging, but showed that our well-established approach to such matters – transparency, collaboration and balance – delivered results which were welcomed by the steelworkers' representatives. ■

WHAT WE DID CREDIT UNIONS

> Credit Unions play a vital role in communities throughout the country.

In 2019, FSCS has paid £4.5m to 11,784 customers of six credit unions that failed during the year.

Credit unions demonstrate how FSCS can provide reassurance quickly, as nearly all depositors receive their money within two days. Members with up to £1,000 in their account receive a letter to get cash over the counter at their local Post Office. Those with a balance of more than £1,000 receive a cheque for their balance direct from FSCS. We work with the appointed insolvency practitioner to mitigate any financial hardship that members might suffer.

Although smaller in scale, these payouts mean our processes are continuously tested and refined, and protocols are in place to ensure protection for a bank or building society as well as a credit union's customers.

The largest credit union to fail in 2019 was the East London Credit Union, t/a Waltham Forest Community Credit Union. The average payment to its 5,525 customers was £368.45 and the total amount paid in compensation was around £2 million.

Speaking of the important role of credit unions, Caroline Rainbird, FSCS's CEO said: "FSCS staff take great pride in all areas of their work, but they know that when a credit union fails, they have helped to protect, in some cases, vulnerable members of society."

Credit unions play a vital role in communities throughout the country as members are listened to and their needs are taken into account with products and services tailored to help people take better control of their finances. Members could be financially vulnerable as they may be dependent on social security benefits, be on a low wage, or have a poor credit history. Credit unions offer a range of savings accounts and affordable loans, which means that credit unions provide vulnerable customers with an alternative to payday lenders. ■

MANAGEMENT EXPENSES

Management expenses

Management expenses	Forecast 2019/20 (£m)	Budget 2019/20 (£m)
Claims handling infrastructure and support	**58.3**	**53.9**
Outsourced claims handling	17.3	13.4
Internal claims handling support	11.7	9.7
Provisions	0.0	2.1
IT, facilities and central services	29.3	28.7
Bank charges	**6.8**	**7.6**
Depositor protection, investment, recoveries and pension deficit	**12.1**	**13.1**
Depositor protection	2.8	2.8
Consumer protection	0.7	0.7
Recoveries	2.7	3.7
Investment: digital and outsourcing	4.0	4.0
Pension deficit funding	1.9	1.9
Total management expenses	**77.2**	**74.6**

NB. Restatements have been included in the above figures

At the midpoint in the 2019/20 financial year, we are forecast to exceed our £74.6m budget by £2.6m (3.5%).

While we continue to identify opportunities to decrease this forecast, the key drivers to this increase stem from unforeseen rises in outsourced claims volumes relating primarily to SIPP and Pension claims of £4.7m (4.1k increase in outsourced claims volume vs. budget).

Additionally, an increase in the volume and complexity of claims that FSCS is dealing with, has directly impacted our legal expense forecast which has risen by £1.5m.

These rising costs of £6.1m (8.3%) have been partially offset by effective claims price negotiations and broader efficiency savings, such as; reduced recovery costs of £1m, favourable rates on our revolving credit facility (RCF) (£0.6m) and no longer needing to include VAT on Independent Insurance claims following a favourable HMRC ruling, giving rise to the £2.6m variance to budget.

As we continue to review further opportunities to close this expense gap, we expect to utilise our unlevied reserve, which is in place to cover unforeseen increases in claims volumes.

UPDATES

ALPHA INSURANCE A/S (ALPHA)

Following the collapse of the Danish insurance company, Alpha on 8 May 2018, FSCS worked with Alpha's liquidator, the Danish Guarantee Fund and the Danish Financial Supervisory Authority, to understand the impact of Alpha's bankruptcy. This essential background work enabled FSCS to lessen the impact of the collapse on Alpha's UK customers and FSCS's levy payers.

Alpha provided a range of insurance products to the UK retail and commercial markets. Since the Alpha bankruptcy was declared in May 2018, FSCS has helped fund a transfer of cover for, or issued return of premium payments to, approximately 229,000 Alpha UK customers. Replacement cover was secured for private and commercial motor insurance policies and Guaranteed Asset Protection (GAP) policies.

To date FSCS has paid £31m in return of premium payments.

FSCS achieved this despite the Liquidator finding Alpha's policy database to be in an incomplete state when they stepped in to take control of the firm.

Although many policyholders have been protected, the attempts to secure replacement cover for Alpha's 20,500, 10-year latent/structural defect policyholders were less straightforward. This was largely due to the difficulties in finding a new insurer that was willing to take on the policies.

Despite a number of extensions of time to find an alternative insurer, by this summer, it was clear that the only recourse was for FSCS to pay a return of premium directly to policyholders. Return of premium payments have now been made to 14,000 latent/structural defect policyholders and we have written to the remaining 6,500 policyholders with instructions on the steps they must take to submit their claim.

We are also asking those policyholders to register their claim on the Alpha claims portal so they can be compensated.

This outcome meant that for some policyholders, the return of premium sum was not adequate to purchase replacement cover and for some they could be in breach of their mortgage terms and conditions if they do not take out a new latent/structural defect policy. We recommended these policyholders contact the British Insurance Brokers Association (BIBA) Find-a-Broker service for brokers who specialise in this product.

We will be exploring further with the Authorities how any future cases can be addressed, firstly by improving customer data and secondly, whether FSCS's role should be amended, for example, to provide an ongoing run off cover for such policies.

STRATEGY FOR THE 2020s
PROTECTING THE FUTURE

In delivering this strategy FSCS aims to respond to the interests of all its key stakeholders': consumers, our customers – the people who use our service, industry, levy payers and the regulators and government.

The trust of all our stakeholders is best maintained if FSCS is independent in its judgments, efficient in its operation, resilient in the face of financial failure and customer focused in the delivery of its services.

It also depends on demonstrating that, while FSCS meets eligible compensation costs, the Scheme also works with the industry and regulators to learn the lessons of past failure in order reduce the costs of failure in the future. ■

Prepare
FSCS must be able to protect consumers in a crisis or in the event of major failures to maintain public confidence and financial stability.

Protect
FSCS is known and trusted for protection that puts people back on track through outstanding customer experience.

Prevent
FSCS collaborates with our regulatory and industry stakeholders to prevent future failure and to reduce compensation costs.

Promote
The full range of FSCS protection is known about and trusted.

Contact us

For more information
call: 0800 678 1100
email: publications@fscs.org.uk
visit: www.fscs.org.uk

Head Office

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

Stay connected

FSCS Linkedin
FSCS @FSCS
FSCS @FSCSbusiness
FSCS FSCSProtected