Financial Services Compensation Scheme

outlook

Industry newsletter from the Financial Services Compensation Scheme | May 2020

CHIEF EXECUTIVE'S STATEMENT

Caroline Rainbird,
Chief Executive

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This is the third FSCS publication that I have introduced in my first year as CEO and I did not expect to deliver it in such circumstances. As the UK is currently facing an unprecedented challenge following the outbreak of COVID-19 this is a testing time for everyone and the impact will be felt for a considerable period.

FSCS remains committed to keeping levy payers, trade bodies, the regulatory family, HM Treasury and MPs updated on levy implications and this edition of *Outlook* confirms the levies for the coming year to cover the forecast funding requirements for FSCS for 2020/21. The levies were agreed prior to the COVID-19 lockdown, and there may be some future failures in the market that we have not planned or budgeted for in this forecast due to any economic downturn that may come. We will keep all stakeholders updated throughout the year.

FSCS is in regular contact with our regulatory partners and the government to ensure the smooth running of the scheme, and although the pandemic has altered our working practices it has not impacted on the day to day delivery of FSCS' service. We have continued to adapt and improve our approach to protect our staff and serve our customers and, as a result of those efforts, business has continued as usual.

Our staff have worked remotely since mid-March, although our offices remain open for the small number who need access to perform specific tasks. Their resolve has reassured customers that we are continuing to review claims and make payments. FSCS continues to provide regular updates via our website as well as ensuring that our call centre phonelines and online live chat functions remain active for those wanting to talk to our staff. This has done much to provide our customers, many of whom are vulnerable, with peace of mind in the knowledge their claims are being processed despite the pandemic.

However, we recognise that business as usual will not be possible for everyone and that some may face challenges due to the current economic situation.

Engagement

The levy remains an important issue for FSCS and engaging with the industry has been a crucial aspect of the work I've carried out this year. Throughout the discussions I've held with firms and trade bodies, it is evident that we share a common goal – to prevent financial mal-practice, to deliver a positive outcome for customers and ensure the financial services sector continues to be fit for purpose.

The industry also recognises the important role FSCS plays in protecting consumers and increasing public confidence in the financial services industry. However, concerns have been raised about the rising trends in compensation costs, increased levy fees, and the potential impact this may have on businesses and the wider sector.

We will continue to work with the industry, regulators and consumers on identifying changes that could address the underlying, interconnected concerns which have been raised, whilst continuing to help to provide confidence and trust in the financial services industry.

> “To address concerns from levy payers we convened industry panels to exchange information on current issues and potential concerns.”

Prevent work

We have heard direct concerns that levy payers are paying for the poor practice, or dishonest behaviour, of those who do not act with integrity. One way that FSCS has sought to address these concerns is by convening industry panels to exchange information on current issues and potential concerns in the investment and pensions, and general insurance markets.

FSCS is also actively seeking to reduce levies through the Prevent pillar of our strategy, which has received positive support from industry. As part of our strategy, FSCS is collaborating with the Financial Conduct Authority (FCA), the Financial Ombudsman Service and The Insolvency Service around phoenixing. Through this workstream, FSCS has successfully identified and reported 117 cases to the FCA, that has contributed positively to the FCA's authorisation and supervision activity.

The Scheme notifies specific cases to the FCA where we see potential harm to consumers or levy payers from CMC activity. The FCA assesses all intelligence it receives. So, far, 79 CMCs have withdrawn their applications for the full FCA authorisation process. FSCS is committed to work with all stakeholders to help reduce poor outcomes for customers; that in turn will decrease the total compensation levy payers have to fund.

Understanding future costs

We appreciate that understanding future costs is important to a business for its planning, and, to help firms understand what additional levies could be on the horizon, we issue Industry newsletters. FSCS issues three Industry publications that set out the levy. The autumn (usually November) edition of *Outlook* provides an overview of the levy position at the mid-year, as well as the first indication of the likelihood of a supplementary levy. We then provide a forecast of the next year's levy in the *Plan and Budget* in mid-January, before the levy figures for the year are confirmed in the (usually) April edition of *Outlook*.

I can confirm that the total levy will be £649m, an increase of £14m since the indicative levy was published in mid-January, this is in part due to compensation relating to London Capital and Finance.

Pensions

We continue to see the impact of pension mis-selling through an ongoing increase in pension related claims. However, the forecast in the January *Plan and Budget 2020/21* for SIPP operator claims has reduced by £7m. This is due to a revision in the expected timing and cost of some recent and expected future SIPP operator failures.

> "The harm caused by people involved with the sale of LCF's mini-bonds and BSPS's transfers highlights the importance of the role of FSCS in protecting the public."

London Capital and Finance (LCF)

This has been one of the most significant cases for FSCS not only in terms of the number of those affected but also in its complexity.

The main change in the compensation forecast since the January indicative levy, is the inclusion of £44m in compensation costs for LCF in the Life Distribution and Investment Intermediation Class.

FSCS has paid £3.3m to 169 LCF customers in relation to bonds that were invested following transfers out of stocks and shares ISAs. As this was a regulated activity, we were able to pay these claims immediately. This is a small proportion of the 11,600 LCF customers, who are mainly of retirement age and invested £237m with LCF. We understand that they will be distressed at losing their savings, however we are only able to pay claims that are eligible under our rules.

Further extensive investigations have since revealed that some customers may be eligible for compensation as they were given misleading advice. At this stage we cannot say how many will receive compensation, but for the purpose of the levy, have estimated an amount of £44m.

Our decision not to find investors' claims eligible on a broader basis has been challenged by investor representatives, who have filed an application for a judicial review. Although we cannot predict the outcome, this could potentially have a significant impact on the levy. We will of course keep the Industry updated.

British Steel Pension Scheme (BSPS)

Another case which shows how lives can be drastically affected is that of the British Steel workers. I recently attended a BSPS roundtable at Westminster alongside representatives from the FCA, the Financial Ombudsman Service, the Pensions Ombudsman and the Pensions Regulator. Calls were made for FSCS to reconsider the level of compensation for steelworkers. Whilst FSCS will continue to review any new and compelling evidence about the quantification methodology that we apply to compensation, it is vital that we remain consistent and operate within our rules to be fair to all customers and our levy payers.

The harm caused by people involved with the sale of LCF's mini-bonds and BSPS's transfers highlights the importance of the role of FSCS in protecting the public. It shows the very real need for our strategy for the 2020s that is set across the pillars of Prepare, Protect, Prevent and Promote.

I wish you all well during these deeply challenging times and I look forward to continuing to work together to achieve our goal for a safer financial services sector that is underpinned by good consumer outcomes.

> "Whilst FSCS will continue to review any new and compelling evidence relating to BSPS, it is vital that we remain consistent and operate within our rules to be fair to all customers and our levy payers."

ANNUAL LEVY 2020/21

Complete updates for each Industry sector, including the variance from the figures published in our indicative levy forecast, can be found in the tables on pages below. This section provides explanations for the sectors experiencing most movement in their annual levy levels. The levies were agreed prior to the COVID-19 lockdown, and there may be some future failures in the market that we have not planned or budgeted for in this forecast due to any economic downturn that may come.

Levy 2020/21. Latest position by funding class.

	2019/20	2020/21		
	Levies Raised (£m)	Indicative Levy (£m)	Final Levy (£m)	Movement (£m)
PRA Classes				
Deposits	(10)	21	**17**	(4)
Life and Pension Provision	28	31	**33**	2
General Insurance Provision	165	118	**126**	8
Home Finance Provision	1	1	**1**	0
FCA Classes				
General Insurance Distribution	12	23	**18**	(5)
Life Distribution and Investment Intermediation	189	213	**229**	16
Home Finance Intermediation	4	3	**1**	(2)
Investment Provision	139	200	**200**	0
Debt Management	0	1	**0**	(1)
Base costs	21	24	**24**	0
	549	**635**	**649**	**14**

The amounts of levies shown are those payable by the classes with the provider contributions included in the paying class.

SECTOR OVERVIEWS

Complete updates for each Industry sector, including the variance from the Indicative Levy published in our recent Plan and Budget, can be found in the tables on pages 6–9. This section provides explanations for the sectors experiencing most movement in their annual levy levels. The levies were agreed prior to the COVID-19 lockdown, and there may be some future failures in the market that we have not planned or budgeted for in this forecast due to any economic downturn that may come.

Deposits

2020/21 Forecast	Final Levy Forecast (£m)	Indicative Levy Forecast (£m)	Variance (£m)
Opening balance	9.30	3.58	5.72
Compensation	(7.68)	(7.68)	0.00
Recoveries	0.50	4.50	(4.00)
Management Expenses	(13.01)	(13.01)	0.00
Annual levy receipts	12.00	13.00	(1.00)
Closing Surplus/(Deficit)	**1.11**	**0.39**	**0.72**

Firms in the Deposits class have seen decreases following the final repayment of the loans from HM Treasury in 2018/19. The 2020/21 levy is set at £17m, which includes £12m for the costs of the deposit class (as shown in the table above) and a £5m provider contribution. Six credit unions failed in the period 1 April 2019 to 31 March 2020, and the total amount paid in compensation was just under £5m.

General Insurance Provision

2020/21 Forecast	Final Levy Forecast (£m)	Indicative Levy Forecast (£m)	Variance (£m)
Opening balance	36.54	27.74	8.80
Compensation	(152.31)	(133.55)	(18.76)
Recoveries	1.20	0.00	1.20
Management Expenses	(4.79)	(4.79)	0.00
Annual levy receipts	120.00	111.00	9.00
Closing Surplus/(Deficit)	**0.64**	**0.40**	**0.24**

The final levy has increased by £7m, to £126m, to take account of the forecasted costs of recent failures – Elite Insurance Company Ltd, Quick-Sure Insurance Ltd and CBL Insurance Ltd. Included in the £126m levy payable by firms in this class is a £6m provider contribution to the General Insurance Distribution class, with £120m payable for the costs of the General Insurance Provision class (see above table).

Investment Provision

2020/21 Forecast	Final Levy Forecast (£m)	Indicative Levy Forecast (£m)	Variance (£m)
Opening balance	28.73	(4.93)	33.66
Compensation	(208.20)	(215.26)	7.06
Recoveries	0.00	0.00	0.00
Management Expenses	(6.84)	(6.84)	0.00
Annual levy receipts	187.00	228.00	(41.00)
Closing Surplus/(Deficit)	**0.69**	**0.97**	**(0.28)**

Although the levy payable by the members of this class remains at the limit of £200m, there have been changes within the class.

The £200m levy payable by firms in this class comprises a £187m levy payable for costs of the Investment Provision class (see above table) and a £13m provider contribution to the Life Distribution and Investment Intermediation class.

The forecasted compensation costs for 2020/21 have reduced by £7m. This reduction is due to a change in the timing and cost of recent SIPP operator failures, as well as failures we expect to happen in the future.

The amount payable is still capped at the £200m class limit for the year. Although due to the costs of the class having reduced, it can now contribute £13m of provider contributions towards the Life Distribution and Investment Intermediation class within the £200m.

The other effect of the funding requirement for this class reducing to below its class limit is that Investment Provision class will not require funding from the retail pool. The indicative levy had forecast a £28m requirement from the retail pool which would have been paid by all other FCA classes. This therefore has the effect of reducing the levies in all other FCA classes.

Life Distribution and Investment Intermediation

2020/21 Forecast	Final Levy Forecast (£m)	Indicative Levy Forecast (£m)	Variance (£m)
Opening balance	7.56	0.24	7.32
Compensation	(269.06)	(221.20)	(47.86)
Recoveries	1.33	1.04	0.29
Management Expenses	(18.83)	(18.83)	0.00
Annual levy receipts	280.00	239.00	41.00
Closing Surplus/(Deficit)	**1.00**	**0.25**	**0.75**

The 2020/21 compensation cost forecast in this class has increased by £48m, mainly due to the inclusion of LCF which we have provisionally estimated will cost £44m in compensation. This means that the amount of funding required by this class, including levies payable as provider contributions by other classes, has increased by £41m to £280m (see above table).

FSCS is subject to a judicial review with regard to the eligibility of some of the LCF products. The levy is calculated on the assumption that the judicial review does not impact on the uphold of claims, and that the eligible customers are paid in the 2020/21 financial year.

Although the amount of funding required by the class has increased by £41m to £280m, the levy payable by firms within the class has increased by £16m to £229m. The main reason is that the levy requirement for Investment Provision has reduced to below its own class limit benefiting firms in the Life Distribution and Investment Intermediation (LDII) class in the following ways:

- The LDII class will no longer have to fund £8m towards the retail pool
- The Investment Provision class will now contribute £13m as a provider contribution to the LDII class.

In total this class will benefit from provider contribution totalling £51m (£13m Investment Provision, £33m Life Insurers and £5m from Deposit acceptors), meaning firms in this class will have to pay £229m.

General Insurance Distribution

2020/21 Forecast	Final Levy Forecast (£m)	Indicative Levy Forecast (£m)	Variance (£m)
Opening balance	(8.80)	(3.10)	(5.70)
Compensation	(8.97)	(7.76)	(1.21)
Recoveries	0.00	0.00	0.00
Management Expenses	(5.71)	(5.71)	0.00
Annual levy receipts	24.00	17.00	7.00
Closing Surplus/(Deficit)	**0.52**	**0.43**	**0.09**

As the Investment Provision class is not now expected to breach its class limit, the General Insurance Distribution class will not need to contribute to the retail pool. This has the effect of reducing the levies payable by firms in the General Insurance Distribution class by £5m to £18m. The class will benefit from a provider contribution of £6m from the General Insurance Provision class.

Home Finance Intermediation

2020/21 Forecast	Final Levy Forecast (£m)	Indicative Levy Forecast (£m)	Variance (£m)
Opening balance	6.72	6.46	0.26
Compensation	(6.57)	(8.05)	1.48
Recoveries	0.00	0.00	0.00
Management Expenses	(1.34)	(1.34)	0.00
Annual levy receipts	2.00	3.00	(1.00)
Closing Surplus/(Deficit)	**0.81**	**0.07**	**0.74**

The amount of funding required by the class has reduced to £2m. Firms in this class will therefore pay £1.5m and firms in the General Insurance Provision class will contribute £0.5m.

MANAGEMENT EXPENSES UPDATE

2019/20 Update

As we finalise the results of the 2019/20 financial year, we are forecast to spend £0.1m over our £74.6m budget. Notwithstanding a number of additional costs, which were not originally budged for, the key drivers of the variance are:

SIPP and Pension claims handling

In 2019/20 we have received 4,100 more claims than budgeted for relating primarily to SIPP and Pension claims resulting in increased expenses of £3.9m.

Volume and complexity of claims

An increase in the volume and complexity of claims that FSCS is dealing with has directly impacted our legal expenses forecast, which has risen by £1.6m.

Savings

These rising costs of £5.5m (7.2%) have been partially offset by effective claims price negotiations and savings arising from:

- Reduced recovery costs (£1.4m).
- Lower than anticipated bank charges (£0.7m).
- The delay in investment spend (£1.3m) as we await the appointment of our Strategic Technology partner.
- The removal of the need to include VAT on Independent Insurance claims handling costs following a favourable HMRC ruling (£2.0m).

Whilst the forecast is over our budget, we do not anticipate that we will need to use the unlevied reserve, which is intended to cover unforeseen increases in claims volumes. We actively sought to find further savings to cover this gap before the year ended and believe that our final costs will be within budget.

Management expenses

Management expenses	Forecast 2019/20 (£m)	Budget 2019/20 (£m)
Claims handling infrastructure and support	**57.7**	**53.9**
Outsourced claims handling	17.3	13.4
Internal claims handling support	12.1	9.7
Provisions	0.0	2.1
IT, facilities and central services	28.3	28.7
Bank charges	**6.7**	**7.6**
Depositor protection, investment, recoveries and pension deficit	**10.3**	**13.1**
Depositor protection	2.7	2.8
Consumer protection	0.7	0.7
Recoveries	2.3	3.7
Investment: digital and outsourcing	2.7	4.0
Pension deficit funding	1.9	1.9
Total management expenses	**74.7**	**74.6**

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

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