Financial Services Compensation Scheme

Outlook
May 2022

In this issue:

Contents

About **FSCS**

FSCS is the UK's financial compensation scheme that protects customers of authorised financial services firms if they fail or have stopped trading.

FSCS is independent and can pay compensation if an authorised firm fails and is unable to pay back money it owes its customers. FSCS' service is completely free to use and is funded by the financial services industry.

Chief Executive's **statement**

Today we are sharing the latest compensation and overall levy forecast for 2022/23. Whilst the headline levy number has decreased since our first forecast in November, the amount of compensation we expect to pay customers during 2022/23 is still greater than the total we paid last year.

The longer-term data also suggests that the year-on-year increase in the amount of compensation we pay to customers will continue. In part, this is because around 80% of people come to us at least five years after dealing with the firm they are making a claim against. Hence the harm has often occurred many years before a claim is made and the compensation paid to the customer.

We submitted an extensive response to the FCA's Compensation Framework Review (CFR) discussion paper in March, where we set out our views on creating a fair and balanced compensation regime for the future. It is important to note that the review is not looking at how FSCS operates. The team continues to provide the customers of failed financial services firms with excellent service, paying compensation where we can do so in an efficient and fair manner.

We have faced criticism from some levy payers over the size of their FSCS bill in recent years, but these costs are only a symptom – driven by poor consumer outcomes and the compensation we need to pay out as a result. FSCS is keen to play a positive and proactive role in shaping the long-term future of the UK's compensation regime, and we believe our submission demonstrates our commitment to being a leading and thoughtful voice in this important debate.

I am very conscious of the impact paying out increasing levels of compensation has on the industry, as well as consumers, and we continue to call for changes that will help address the root causes – such as scams, poor practice, and gaps in financial education – so that the costs of the levy can be sustainably reduced over time.

We also support further exploration and analysis of alternative compensation funding models, including the retail pool concept which we know causes particular frustration in some parts of the industry. Although changing the current model will not eliminate the underlying issues, we appreciate that it may alleviate some of the pressure on levy payers.

In relation to compensation funding, there is one area in particular that needs highlighting, and that is pensions. The scale of the financial loss experienced by many consumers in this area highlights the impact the current compensation limit has on our ability to put people back on track, leaving many with pension shortfalls. These losses are compounded by the fact that in the UK we have low pension engagement, with many people not checking their pensions regularly or taking the time to understand how their money is invested. People often do not realise the consequence of poorly advised decisions on their retirement plans until it is too late for them to recover their losses. This can have a devastating financial and emotional impact.

We have also published some of the data and insights that we put forward in our submission to the CFR, and we look forward to seeing the full detail of responses to the discussion paper.

The latest 2022/23 levy forecast

In our latest *Outlook* we share our latest total levy forecast for 2022/23 of £625m. Although this is a decrease from the final 2021/22 levy of £717m, we expect compensation costs for the year to be greater. Surpluses from 2021/22 have allowed us to reduce the amount billed to firms, but past instances of consumer harm continues to drive high levels of compensation.

Following consultation earlier this year, the PRA and FCA confirmed our Management Expenses Levy Limit (MELL) at £110.5m. This covers our expected running costs for the year plus a contingency for unexpected costs which we do not bill to firms unless required. The total levy forecast of £625m includes a revised management expenses levy of £85m, as we have now factored in a surplus from last year of £11m.

As Fiona Kidy, our Chief Finance Officer and Lila Pleban, our Chief Communications Officer, explain in their video, the uncertain economic situation continues to pose a challenge when it comes to forecasting potential firm failures. Even a small number of firms failing earlier or later than expected can make a big difference to the amount of compensation we need to pay to customers. In our revised forecast we still expect the majority of the compensation this year to come from firms that have already failed, so even if we see fewer new failures than expected, the compensation costs will remain high.

Claim complexity also has an impact on our costs. We continue to see many claims in areas such as pension advice and general insurance that take significant amounts of time to investigate and resolve. They also require expertise and often rely on third parties to provide information and evidence which can take many months. These claims tend to be higher value, but we are seeing their costs spread over more years than we initially expected due to their complexity.

FSCS's priorities for 2022/23

Providing a trusted compensation service that helps build confidence in the industry is at the core of our mission. The 'Prepare' and 'Protect' parts of our strategy are about ensuring we deliver this and put our customers back on track as soon as possible. This year, alongside handling the firm failures and claims that come to us, we are working on our customer experience of the future – how we can continue delivering great service whilst leveraging new technology, innovation and managing our costs. There is also a new part of the market coming under FSCS protection, Funeral Plans, which will have its own funding class. We are embedding this new area into our business so that we are prepared for any failures that happen after the firms come under FCA regulation at the end of July.

This year, £698m is forecast to go to our customers as compensation. The 'Promote' and 'Prevent' areas of our strategy look to address the harm that underpins this cost, both through initiatives that we lead and through collaboration with the regulatory bodies and industry. We continue to support existing work in these areas, such as the FCA's Consumer Investments Strategy. We are also working on clearly defining FSCS's ambition for consumers. We believe there is value in going beyond raising general awareness of the compensation scheme and are looking at specific groups of consumers and 'moments' in their lives where we can have the greatest impact.

One of these moments is when a customer realises they can make a claim with FSCS, and must choose whether to claim directly for free, or use the services of a representative. We have recently spoken to a number of our customers who chose to use representatives to find out more about why they made that decision and how much they knew about their options. 41% of the customers we spoke to were not aware there was a free option, and around three in five told us they would definitely make a claim directly for free if they ever had cause to do so again. The insights from this research are helping us shape the next phase of our consumer strategy.

To support our work, data is key. We are creating a new insight and data hub for our teams to use and we are continuing to invest in our data capabilities so that our unique view on the industry can be captured and shared. This will help us continue to highlight issues and opportunities to the industry, regulators and others. It also helps to expose poor behaviour and pinpoint the root causes of harm so that effective solutions can be proposed.

Data also helps us with our recoveries work. Once we have paid compensation, the customers' legal rights are transferred to FSCS. This allows us to try and recoup the compensation we have paid which essentially offsets future levies. Sometimes we recover uncompensated losses too, which we are able to pass onto customers. We can pursue recoveries against the firm that has failed, usually by making a claim in the firm's insolvency, and against any relevant third parties who may also carry legal responsibility for our customers' losses. These might include, for example, the professional indemnity insurers of the firm in default. Since the 2015/16 financial year, we have successfully recovered more than £290m.

We will continue to update our levy forecasting throughout the year and will share our next major update with you in the autumn edition of *Outlook*.

Caroline Rainbird
Chief Executive

2022/23 levy **update**

- The annual levy for 2022/23 is now **£625m**, this is lower than the indicative levy announced in *Outlook* in November 2021, and a decrease from the final 2021/22 levy which was £717m.
- Although the levy forecast has decreased, we still expect compensation costs in 2022/23 to be higher than for 2021/22. We will publish final figures for 2021/22 in our *Annual Report* in the summer.
- A retail pool levy will not be required in 2022/23 as we no longer expect the Life Distribution and Investment Intermediation (LDII) class to breach its annual levy limit and require additional funding.
- We expect to pay compensation to customers who have experienced losses from over 1,000 different firms which failed in previous years.

The updated levy is currently driven by:

- A **£128m** decrease against forecast in compensation paid to customers in 2021/22 resulted in surpluses being carried forward into 2022/23. The majority of this decrease was due to:
  - a £54m reduction in compensation paid in the LDII class due to fewer complex pension claims being received than previously forecast;
  - a £14m reduction in compensation paid in the Investment Provision class due to fewer SIPP operator failures than previously forecast; and
  - a £56m reduction in compensation paid in the General Insurance Provision class. Some of these claims decisions are now expected in 2022/23, primarily in relation to East West Insurance Company Ltd.
- A decrease of **£162m** in compensation forecasted for 2022/23, the two classes with the biggest decrease are:
  - the LDII class with a £65m reduction due to fewer claims decisions expected for complex pension claims; and
  - the Investment Provision class with a £99m reduction due to fewer SIPP operator failures expected.

Compensation costs for 2022/23 are still expected to be higher than in 2021/22. We continually review our underlying assumptions as these are affected by when firms fail and the timing and complexity of claims.

Outlook provides our latest update for the 2022/23 financial year; we will publish the next version later in the year.

Updated 2022/2023 levy

	2021/22 levy (£m)	2022/23 indicative levy (£m)	2022/23 levy (£m)	Movement to 2021/22 (£m)	Movement to indicative (£m)
PRA classes					
Deposits	28.8	47.1	**18.4**	(10.3)	(28.7)
Life and Pension Provision	35.0	35.0	**31.1**	(3.9)	(3.9)
General Insurance Provision	170.4	263.8	**211.7**	41.3	(52.1)
FCA classes					
General Insurance Distribution	13.2	67.7	**5.3**	(8.1)	(62.4)
Investment Provision	200.0	200.0	**115.4**	(84.6)	(84.6)
Life Distribution and Investment Intermediation (LDII)	240.0	240.0	**213.1**	(26.9)	(26.9)
Home Finance Providers	1.3	3.4	**0.0**	(1.3)	(3.4)
Home Finance Intermediation	3.5	9.1	**0.0**	(3.5)	(9.1)
Debt Management	0.4	3.8	**0.0**	(0.4)	(3.8)
Funeral Plans	n/a	0.0	**0.0**	0.0	0.0
Base costs	24.1	30.0	**30.0**	5.9	0.0
Total levies	716.8	900.0	**625.0**	(91.9)	(275.0)

Funeral plans

- The 2022/23 financial year will be the first year of the Funeral Plans funding class.
- From 29 July 2022, the Financial Conduct Authority (FCA) will start regulating firms and intermediaries that provide and arrange pre-paid funeral plans.
- In 2022/23 we are not expecting any firm failures in the newly regulated market or compensation costs in this class.
- Newly authorised firms do not pay any levies in their first year of regulation and therefore firms in this class will not be required to pay an annual levy in 2022/23.

Payment on account

Summer 2022: All PRA and FCA regulated firms will be sent an annual levy invoice.

We have already invoiced firms £269m for payment on account for the 2022/23 levy. For those that made an advanced payment in March 2022, this will be deducted from their annual levy invoice in the summer.

Levy breakdown – PRA classes

Deposits

2022/23 update

2022/23 forecast fund balances	November's *Outlook* forecast (£m)	Latest levy update (£m)	Variance (£m)
Opening balance	6.7	13.6	6.9
Compensation	(12.7)	(12.0)	0.7
Recoveries	0.0	0.0	0.0
Management Expenses	(14.9)	(14.1)	0.8
Annual levy receipts	22.0	14.0	(8.0)
Total closing surplus/(deficit) Please note that the 'Annual levy receipts' excludes provider contributions.	**1.2**	**1.5**	**0.3**

Total levies The 'Total levies' includes provider contributions to other classes. Please note, the 'Total levies' is not the sum of each column. This row shows the November forecast in comparison to the latest levy update.	**47.1**	**18.4**	**(28.7)**

The deposits class has seen a decrease in the amounts firms will have to pay since our indicative levy forecast in November's *Outlook* and has decreased from £47m to £18m. The main reasons include:

- A £21m retail pool contribution will no longer be required by this class as we no longer expect the Life Distribution and Investment Intermediation (LDII) class to breach its annual levy limit and require additional funding from other classes; and
- Due to lower than expected compensation costs in 2021/22, plus £2m in recoveries, the opening balance for this class has increased by a further £7m which has been offset against the 2022/23 levy.

In line with trends seen in previous years, we expect a small number of credit union firm failures during 2022/23.

Levy breakdown – PRA classes

General Insurance Provision

2022/23 update

2022/23 forecast fund balances	November's *Outlook* forecast (£m)	Latest levy update (£m)	Variance (£m)
Opening balance	(5.4)	41.5	46.9
Compensation	(231.1)	(236.8)	(5.7)
Recoveries	1.8	1.8	0.0
Management Expenses	(6.0)	(7.2)	(1.2)
Annual levy receipts	242.0	210.0	(32.0)
Total closing surplus/(deficit) Please note that the 'Annual levy receipts' excludes provider contributions	**1.4**	**9.3**	**7.9**

Total levies The 'Total levies' includes provider contributions to other classes. Please note, the 'Total levies' is not the sum of each column. This row shows the November forecast in comparison to the latest levy update.	**263.8**	**211.7**	**(52.1)**

The levy for this class has decreased from £264m since November's indicative levy forecast to £212m. The main reasons include:

- The compensation costs for 2021/22 were £55m lower than forecast in November's *Outlook*. One of the main reasons for this was that the compensation costs relating to East West Insurance Company Ltd were £34m lower than anticipated. The underspend was for two reasons:
  - There was limited claims data available when forecasting for the 2021/22 period.
  - The market demand for experts, suppliers, and materials, particularly considering the Government's support scheme to address the cladding crisis in the UK, has caused delays for this portfolio; and
- The lower compensation costs in 2021/22 resulted in a £42m surplus in the opening balance in this class and has been offset against the 2022/23 levy.
- A £19m retail pool contribution will no longer be required by this class. This is because we no longer expect the Life Distribution and Investment Intermediation (LDII) class to breach its annual levy limit and require additional funding from other classes.

Despite the overall reduction in the levy, the expected compensation costs for this class in 2022/23 have increased slightly from £231m in November’s indicative levy to £237m. This increase mainly relates to approximately £39m in compensation costs expected for MCE Insurance Company Ltd. This firm was declared in default on 19 November 2021 and was not included in November’s indicative levy forecast.

The increase in compensation costs related to MCE Insurance Company Ltd was offset, by a £45m reduction in expected compensation costs in relation to East West Insurance Company Ltd.

Levy breakdown – PRA classes

Life and Pension Provision

2022/23 update

2022/23 forecast fund balances	November's *Outlook* forecast (£m)	Latest levy update (£m)	Variance (£m)
Opening balance	0.0	(0.3)	(0.3)
Compensation	0.0	0.0	0.0
Recoveries	0.0	0.0	0.0
Management Expenses	0.0	0.0	0.0
Annual levy receipts	0.0	0.0	0.0
Total closing surplus/(deficit) Please note that the 'Annual levy receipts' excludes provider contributions.	**0.0**	**(0.3)**	**(0.3)**

Total levies The 'Total levies' includes provider contributions to other classes. Please note, the 'Total levies' is not the sum of each column. This row shows the November forecast in comparison to the latest levy update.	**35.0**	**31.1**	**(3.9)**

We do not expect any failures in this class in 2022/23. The levy for this class is driven by provider contributions to the Life Distribution and Investment Intermediation (LDII) class, which will be £31m in 2022/23. This is approximately £4m lower than set out in November's indicative levy as the funding requirement of the LDII class has decreased.

Levy breakdown – FCA classes

General Insurance Distribution

2022/23 update

2022/23 forecast fund balances	November's *Outlook* forecast (£m)	Latest levy update (£m)	Variance (£m)
Opening balance	(1.2)	1.7	2.9
Compensation	(1.5)	(2.0)	(0.5)
Recoveries	0.0	0.0	0.0
Management Expenses	(7.5)	(5.9)	1.6
Annual levy receipts	11.0	7.0	(4.0)
Total closing surplus/(deficit) Please note that the 'Annual levy receipts' includes provider contributions.	**0.8**	**0.8**	**0.0**

Total levies The 'Total levies' excludes provider contributions from other classes. Please note, the 'Total levies' is not the sum of each column. This row shows the November forecast in comparison to the latest levy update.	**67.7**	**5.3**	**(62.4)**

The levy for this class has decreased from £68m as forecast in November's indicative levy to £5m. The main reason for this is that the class will no longer be required to make a £59m retail pool contribution to the Life Distribution and Investment Intermediation (LDII) class. This is because we no longer expect the LDII class to breach its annual levy limit and require additional funding from other classes.

We are not expecting any new failures in 2022/23. However, there are close to £2m in compensation pay-outs expected which relate to firm failures in previous financial years.

Levy breakdown – FCA classes

Life Distribution and Investment Intermediation (LDII)

2022/23 update

2022/23 forecast fund balances	November's *Outlook* forecast (£m)	Latest levy update (£m)	Variance (£m)
Opening balance	(17.0)	40.0	57.0
Compensation	(372.5)	(308.0)	64.5
Recoveries	6.2	4.5	1.7
Management Expenses	(21.6)	(27.7)	(6.1)
Annual levy receipts	406.0	293.0	(113.0)
Total closing surplus/(deficit) Please note that the 'Annual levy receipts' includes provider contributions.	**1.1**	**1.8**	**0.7**

Total levies The 'Total levies' excludes provider contributions from other classes. Please note, the 'Total levies' is not the sum of each column. This row shows the November forecast in comparison to the latest levy update.	**240.0**	**213.1**	**(26.9)**

The levy payable by firms in this class is £213m, which is £27m lower than November's indicative levy and the total levy paid by this class in 2021/22. The main reasons for the reduction include:

- The compensation costs for 2021/22 were £276m, £55m lower than forecast in November's *Outlook*. This is because we received fewer claims than expected related to complex pension advice and more claims related to self-invested personal pension (SIPP) advice. SIPP advice claims tend to have lower average compensation pay-outs (about £20k per claim) than the more complex claims related to pension advice (about £50k per claim). Notwithstanding this, we continued to see a trend of increased compensation pay-outs for complex pension advice claims which went from £81m in 2020/21 to £120m in 2021/22;
- The lower compensation costs in 2021/22 resulted in a £40m surplus in this class and was offset against the 2022/23 levy; and
- The expected compensation costs for 2022/23 have decreased from £373m to £308m. This is largely due to a £130m reduction in the compensation costs relating to complex pension claims as we have re-phased some of the claims into 2023/24.

As a result of re-phasing some claims, this class is no longer forecast to breach its annual levy limit and require a £113m retail pool contribution from other classes.

Levy breakdown – FCA classes

Investment Provision

2022/23 update

2022/23 forecast fund balances	November's *Outlook* forecast (£m)	Latest levy update (£m)	Variance (£m)
Opening balance	60.2	77.5	17.3
Compensation	(236.8)	(138.1)	98.7
Recoveries	0.0	0.0	0.0
Management Expenses	(9.7)	(9.7)	0.0
Annual levy receipts	187.0	71.0	(116.0)
Total closing surplus/(deficit) Please note that the 'Annual levy receipts' excludes provider contributions.	**0.7**	**0.7**	**0.0**
Total levies The 'Total levies' includes provider contributions to other classes. Please note, the 'Total levies' is not the sum of each column. This row shows the November forecast in comparison to the latest levy update.	**200.0**	**115.4**	**(84.6)**

Since the indicative levy was published in November, the forecast for this class has decreased from £200m to £115m, which is £85m lower than the indicative levy and the levy paid in 2021/22. The main reasons for the decreased levy for the Investment Provision class include:

- We received fewer claims relating to self-invested personal pension (SIPP) operator claims than expected in 2021/22 as we continued to wait on decisions from the Financial Ombudsman Service. Once these decisions are made, we expect this to lead to several SIPP operator firm failures and claims to FSCS, particularly now that the Supreme Court has declined permission to appeal the Adams v Carey case which relates to the obligations of SIPP operators. We expect these claims to occur in 2023/24 and beyond;
- Due to fewer claims received in 2021/22, the opening balance in this class increased by a further £17m, which was carried forward into 2022/23 and offset against the levy; and
- The expected compensation costs for 2022/23 have decreased by £99m, primarily as we have reassessed the number of SIPP operator claims expected this year to align more with the claims trend in 2021/22.

Levy breakdown – FCA classes

Home Finance Providers

2022/23 update

2022/23 forecast fund balances	November's *Outlook* forecast (£m)	Latest levy update (£m)	Variance (£m)
Total levies	**3.4**	**0.0**	**(3.4)**

We do not receive claims from home management providers as they are not eligible for FSCS compensation. However, they do pay a provider contribution to the Home Finance Intermediation class and a retail pool levy when required.

This class will not be required to pay contributions in 2022/23.

Levy breakdown – FCA classes

Home Finance Intermediation

2022/23 update

2022/23 forecast fund balances	November's *Outlook* forecast (£m)	Latest levy update (£m)	Variance (£m)
Opening balance	5.2	8.7	3.5
Compensation	(5.0)	(0.6)	4.4
Recoveries	0.0	0.0	0.0
Management Expenses	(2.1)	(1.0)	1.1
Annual levy receipts	2.0	0.0	(2.0)
Total closing surplus/(deficit)	**0.1**	**7.1**	**7.0**

Total levies Please note, the 'Total levies' is not the sum of each column. This row shows the November forecast in comparison to the latest levy update.	**9.1**	**0.0**	**(9.1)**

Firms in this class will not be required to pay an annual levy in 2022/23. The main reasons for this include:

- Lower than expected compensation costs in 2021/22, the opening balance for this class has increased by a further £3.5m which has been used to offset against the 2022/23 levy;
- An £8m retail pool contribution will no longer be required by this class. This is because we no longer expect the Life Distribution and Investment Intermediation (LDII) class to breach its annual levy limit and require additional funding from other classes; and
- The compensation pay-outs expected for 2022/23 have decreased from £5m to £1m.

We are not expecting any new failures in 2022/23 and the close to £1m compensation pay-outs expected relate to firm failures in previous financial years.

Levy breakdown – FCA classes

Debt Management

2022/23 update

2022/23 forecast fund balances	November's *Outlook* forecast (£m)	Latest levy update (£m)	Variance (£m)
Opening balance	0.5	0.5	0.0
Compensation	0.0	0.0	0.0
Recoveries	0.0	0.0	0.0
Management Expenses	0.0	0.0	0.0
Annual levy receipts	0.0	0.0	0.0
Total closing surplus/(deficit)	**0.5**	**0.5**	**0.0**
Total levies Please note, the 'Total levies' is not the sum of each column. This row shows the November forecast in comparison to the latest levy update.	**3.8**	**0.0**	**(3.8)**

Firms in this class will not be required to pay an annual levy in 2022/23.

In the indicative levy published in November's *Outlook*, it was forecast that this class would pay close to £4m in levies driven by this class's contribution to the retail pool. However, this is not required because we no longer expect the Life Distribution and Investment Intermediation (LDII) class to breach its annual levy limit and require additional funding from other classes.

As per November's indicative levy, we are not expecting any firm failures or compensation costs for the Debt Management class during the 2022/23 financial year.

Contact us

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 Facebook
FSCS Instagram
FSCS Linkedin
FSCS Podcast
FSCS @FSCS