

## FINANCIAL SERVICES COMPENSATION SCHEME AND HM TREASURY FRAMEWORK DOCUMENT

This framework document has been drawn up by HM Treasury in consultation with the Financial Services Compensation Scheme Limited (FSCS) and the Financial Services Authority (FSA). The document sets out the broad framework within which the Financial Services Compensation Scheme operates. The document does not convey any legal powers or responsibilities and is not legally binding or have legal force or effect on the parties. It is signed and dated by HM Treasury and the Financial Services Compensation Scheme.

The Financial Services Authority has confirmed that the legal relationship between the FSCS and the FSA as defined in the Financial Services and Market Act 2000 (FSMA) is correctly set out.

Copies of the document have been placed in the Libraries of both Houses of Parliament and made available to members of the public on the Financial Services Compensation Scheme website.

### 1. PURPOSE OF THE FINANCIAL SERVICES COMPENSATION SCHEME

- 1.1 FSCS was set up by Financial Services Authority in accordance with Part XV of the Financial Services and Markets Act 2000 (FSMA). FSCS is manager of a single scheme under FSMA to provide compensation in the event of an authorised financial services firm being unable, or likely to be unable, to meet claims against it.
- 1.2 Its statutory duties involve assessing and paying compensation to claimants, in accordance with the scheme rules, in respect of claims made in connection with regulated activities carried on by authorised financial services firms and raising levies on authorised financial services firms to meet its costs. FSCS is not regarded as exercising functions on behalf of the Crown (Section 212(6) of FSMA).
- 1.3 The Scheme protects the following:
  - Deposits;
  - Insurance policies;
  - Insurance intermediation (for business on or after 14 January 2005), including connected travel insurance (for business on or after 1 January 2009);
  - Investment business, and
  - Home finance intermediation (for business on or after 31 October 2004).

### 2 GOVERNANCE AND ACCOUNTABILITY

#### Legal Origins of Power

- 2.1 The powers and duties of the FSCS are derived from Part XV (and XVA) of Financial Services and Markets Act 2000 (FSMA).
- 2.2 FSCS is a private company limited by guarantee, set up under Section 212 of the Financial Services and Markets Act 2000 (FSMA).

### 3. RELATIONSHIP WITH THE FINANCIAL SERVICES AUTHORITY (FSA)

- 3.1 FSCS is operationally independent of the FSA in carrying out its statutory functions. However, under Section 212 of the Financial Services and Markets Act 2000 (FSMA) the

FSA must take such steps as are necessary to ensure that the Scheme is, at all times, capable of exercising those functions.

### 3.2 The FSA is responsible for:

- The appointment (in the case of the chairman normally for a term of three years, renewable once) and removal from office of the chairman and other members of the board (in the case of the chairman acting with the approval of HM Treasury). The terms of their appointment (and in particular the terms governing removal from office) must be such as to secure their independence from the FSA in the operation of the Scheme (Section 212(5) of FSMA).
- The rules governing the Scheme which are set out in the Compensation sourcebook and chapter 6 of the Fees manual of the FSA Handbook.
- Receiving (together with HM Treasury) an annual report from FSCS on the discharge of its functions.
- Fixing the limit on the amount which the FSCS may recover, from sums levied under the scheme, by way of management expenses for a particular period (the Management Expenses Levy Limit).

## Funding

- 3.3 FSCS is funded by the financial services industry. Section 213(3)(b) of FSMA gives FSCS the power to impose levies on authorised persons to meet its expenses including the costs of paying compensation, borrowing or insuring risks. The FSA is responsible for making the rules governing the funding arrangements for the Scheme.
- 3.4 Proposed reforms to the FSMA mean the FSA is expected to split into the Prudential Regulation Authority and Financial Conduct Authority from 2013. The draft Financial Services Bill indicates that under Part XV of FSMA, the FCA and the PRA will be required to take such steps as they consider appropriate to co-operate with each other to exercise their statutory functions in respect of the FSCS.

## 4 RELATIONSHIP WITH HM TREASURY

- 4.1 HM Treasury is responsible for the overall institutional structure of financial regulation and the legislation which governs it, including the negotiation (and implementation) of EC Directives. HM Treasury is also responsible for informing and accounting to Parliament for the management of serious problems in the financial system, and, where applicable, measures used to resolve them.
- 4.2 FSCS puts into operation the rules made by the FSA in respect of compensation arrangements and funding of the Scheme to eligible claimants. It includes those requirements set out under certain EC Directive requirements: in particular under the Deposit Guarantee Schemes Directives and the Investor Compensation Schemes Directive.
- 4.3 Under the policy of aligning budgets with estimates and accounts (Clear Line of Sight), FSCS's accounts will be consolidated into the HM Treasury Group annual resource accounts. Through the interim and final accounts consolidation process, HM Treasury will seek appropriate reassurances on the operation of the systems, controls and processes

that underpin the production of FSCS's accounts affecting the overall accuracy of HM Treasury Group accounts and within relevant levels of materiality represent a true and fair view.

- 4.4 FSCS may occasionally borrow from HM Treasury in order to fund compensation costs which the financial services industry cannot absorb immediately without detriment to financial stability. In these circumstances, FSCS and HM Treasury will negotiate over the terms of such borrowing and their respective accounting officers will give priority to their own accountabilities, including statutory accountabilities, in conducting such negotiations.

## 5 HM TREASURY'S ACCOUNTING OFFICER'S SPECIFIC ACCOUNTABILITIES AND RESPONSIBILITIES

- 5.1 HM Treasury's Principal Accounting Officer (PAO) has designated FSCS's Chief Executive as the FSCS's Accounting Officer.
- 5.2 HM Treasury's PAO is accountable to Parliament for preparing and signing HM Treasury's accounts, including the consolidation of FSCS's accounts.
- 5.3 HM Treasury has responsibility for ensuring, through the FSCS's Chief Executive, that the Scheme accounts are properly audited and in a fit state to be consolidated within HM Treasury's accounts. The FSCS's Chief Executive is responsible for preparing those accounts.
- 5.4 HM Treasury's PAO is not responsible for regularity, propriety or value for money at FSCS. The Chief Executive of FSCS, reporting to FSCS's board holds these responsibilities and is to provide appropriate assurance to the Treasury's PAO on regularity and propriety for FSCS's element of the HM Treasury Group consolidated account as section 6 sets out.

## 6 RESPONSIBILITIES OF THE CHIEF EXECUTIVE AS THE FINANCIAL SERVICES COMPENSATION SCHEME'S ACCOUNTING OFFICER

- 6.1 The Chief Executive of FSCS - as Accounting Officer - is personally responsible for:
- safe guarding the public funds for which he or she has charge. In the case of FSCS, this takes the form of levies on the financial services industry;
  - ensuring regularity and propriety in the handling of those public funds;
  - the day-to-day operations and management of FSCS; and
  - ensuring that, subject to his/her duties under FSMA and the Companies Act, that FSCS as a whole is run on the basis of the standards, in terms of governance, decision-making and financial management that are set out in Box 3.1 to Managing Public Money. ([http://www.hm-treasury.gov.uk/d/mpm\\_whole.pdf](http://www.hm-treasury.gov.uk/d/mpm_whole.pdf))
- 6.2 FSCS's Accounting Officer is responsible to FSCS's Board for:
- advising on the discharge of the board's responsibilities under FSMA, or as set out in this document, in the founding legislation and in any other relevant instructions and guidance that may be issued from time to time;
  - advising the board on FSCS's performance compared with its aims and objectives; and

- ensuring that financial considerations are taken into account by the board in reaching its decisions, and that financial appraisal techniques are followed.
- 6.3 The FSCS' Accounting Officer's responsibilities for accounting to Parliament include:
- signing the accounts and ensuring that proper records are kept relating to the accounts, and that the accounts are properly prepared and presented in accordance with any directions issued by and agreed with HM Treasury;
  - signing a Statement of Accounting Officer's responsibilities, under this framework, for inclusion in the annual report and accounts;
  - signing a Statement on Internal Control regarding the system of internal control, for inclusion in the annual report and accounts; and
  - giving evidence when summoned before the PAC on the Scheme's stewardship of the funds provided to it by the financial services industry through the levy.
- 6.4 Fully respecting the independence of FSCS in carrying out its statutory function, FSCS's Accounting Officer is responsible to HM Treasury for:
- ensuring that timely forecasts and monitoring information on finance are provided to HM Treasury on a basis agreed between FSCS and HM Treasury;
  - notifying HM Treasury promptly if material over- or under-spends are likely and taking any corrective action; and
  - notifying HM Treasury in a timely fashion of any significant operational problems whether financial or otherwise, and whether detected by internal audit or by other means, likely to impact on the accounts and audit opinion.

## 7 THE FSCS BOARD

- 7.1 The role of the Board under the Companies Act 2006 is to lead and oversee the affairs of FSCS and, consistent with the Act, its primary duty is to promote the interests of FSCS. The Board is specifically responsible for:
- making strategic decisions ;
  - overseeing the discharge by the executive management of the day-to-day business of FSCS;
  - setting appropriate policies to manage risks to FSCS's operations and seeking regular assurance that the system of internal control within FSCS is effective at risk mitigation;
  - maintaining a sound system of financial control;
  - producing and filing an appropriately audited Annual Report and Accounts;
  - taking specific decisions which the Board or executive management consider to be of such significance as to require to be taken by the Board; and
  - maintaining high level relations with other organisations and authorities, including the Financial Services Authority and Government.
- 7.2 There are currently formal committees of the Board – also with non-executives in the majority – covering: audit; nominations; remuneration; and contingencies planning. The Remuneration Committee determines the pay and other conditions of the four Executive Directors and also approves wider remunerations policy.

## 8 ANNUAL REPORT AND ACCOUNTS

- 8.1 FSCS must pass its annual report to the FSA and HM Treasury in relation to the discharge of its functions and publish it in a way it considers appropriate. Before the end of each financial year, FSCS and HM Treasury shall agree a timetable for FSCS to provide HM Treasury financial information in an agreed format for consolidation. This will be in sufficient time to enable HM Treasury to meet its external reporting requirements and will also allow FSCS reasonable time to prepare the finalised (audited) accounts.
- 8.2 The annual report must comply with any requirements specified in rules, if any, made by FSA.
- 8.3 In line with normal practice the annual report and accounts shall be published and made available on FSCS's website.
- 8.4 FSCS's financial statements are produced in accordance with the Companies Act(s) and UK GAAP. The Scheme is also required, under Section 218 of FSMA, to report yearly to the FSA on the discharge of its function. The Scheme fulfils both of these requirements with its Annual Report.
- 8.5 FSCS voluntarily follows the provisions of the UK Corporate Governance Code (and formerly the Combined Code on Corporate Governance), and, accordingly, provides a full report on the extent to which the company complies with the provisions of that Code, on a 'comply or explain' basis, in the Corporate Governance section of its Annual Report.

## 9 INTERNAL AUDIT

- 9.1 FSCS shall establish and maintain arrangements for internal audit.

## 10 EXTERNAL AUDIT

- 10.1 From commencement of the Financial Services Act, FSCS agrees to appoint the Comptroller & Auditor General (C&AG) to audit the Service's annual accounts. FSCS will pass the audited accounts to HM Treasury in line with the agreed consolidation timetable to be consolidated within HM Treasury's resource accounts.
- 10.2 HM Treasury has an interest in the external audit of FSCS, in particular on issues impacting on HM Treasury's responsibilities in relation to the accuracy of HM Treasury Group consolidated account. The C&AG will share with HM Treasury information identified during the audit process and the audit report (together with any other outputs) at the end of the audit.

## 11 CORPORATE GOVERNANCE

- 11.1 FSCS shall ensure that the risks that it faces are dealt with in an appropriate manner, in accordance with relevant aspects of best practice in corporate governance, and shall develop a risk management strategy. It shall adopt and implement policies and practices to safeguard itself against fraud and theft. It should also take all reasonable steps to

appraise the financial standing of any firm or other body with which it intends to enter into a contract.

## 12 ANNUAL PLAN

- 12.1 FSCS publishes its Plan and Budget on its website, in which it sets out its plans for the year ahead. The Plan and Budget provide advance notice of expected costs to the Scheme (including management expenses, compensation and interest costs), indicative levy figures, updates on failures and recoveries, claim trends and its investment strategy.
- 12.2 FSCS shall agree to provide advance sight of the annual plan to the FSA during the preparation of the annual plan.

## 13 BUDGETING PROCEDURES

- 13.1 FSCS will have a separate line in HM Treasury's Estimate<sup>1</sup> which will show an estimate of budget expenditure. The Service will be able to submit an additional Memorandum alongside that of HM Treasury. This will protect the independence of the Service and ensure transparency in the resources that are provided to the Service.

## 14 FINANCIAL SERVICES COMPENSATION SCHEME STAFF

- 14.1 FSCS has responsibility for the recruitment, retention and motivation of its staff under the governance framework set out in paragraph 7.1.

## 15 Signatures and dates

Signed for and on behalf of  
FSCS

Name **MARK NEALE**

Signature 

Date **9 November 2012**

Position **CEO**

Signed for and on behalf of  
HM Treasury

Name **JULIAN KELLY**

Signature **J. Kelly**

Date **9 November 2012**

Position **Finance Director**

<sup>1</sup> Estimates seek Parliamentary authority for voted resources, capital and cash both for existing services and for any necessary new services. They include non-cash items such as depreciation. For further information please see [http://www.hm-treasury.gov.uk/psr\\_estimates\\_mainindex.htm](http://www.hm-treasury.gov.uk/psr_estimates_mainindex.htm)

## Appendix A

### GOVERNMENT WIDE CORPORATE GUIDANCE AND INSTRUCTIONS

The Financial Services Compensation Scheme shall comply with the broad principles of the following general guidance documents and instructions. The Scheme's AO should be able to justify any significant deviations from guidance.

- This document;
- Managing Public Money (MPM)  
[http://www.hm-treasury.gov.uk/psr\\_mpm\\_index.htm](http://www.hm-treasury.gov.uk/psr_mpm_index.htm)
- Management of Risk: Principles and Concepts  
[http://www.hm-treasury.gov.uk/orange\\_book.htm](http://www.hm-treasury.gov.uk/orange_book.htm)
- Managing the Risk of Fraud  
[http://www.hm-treasury.gov.uk/psr\\_managing\\_risk\\_of\\_fraud.htm](http://www.hm-treasury.gov.uk/psr_managing_risk_of_fraud.htm)
- Government Financial Reporting Manual (FReM)  
[www.financial-reporting.gov.uk](http://www.financial-reporting.gov.uk)
- Relevant Dear Accounting Officer letters;
- The Parliamentary Ombudsman's Principles of Good Administration  
[www.ombudsman.org.uk/improving-public-service/ombudsmansprinciples](http://www.ombudsman.org.uk/improving-public-service/ombudsmansprinciples)