News from the Financial Services Compensation Scheme

outlook

December 2016

Compensating customers since 2001

HALF YEAR UPDATE

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- Funding indicators for six months to 30 September

LATEST POSITION

- Enterprise Insurance
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CHIEF EXECUTIVE'S STATEMENT

Mark Neale, Chief Executive

I am well aware that the volatility of FSCS's levies presents a challenge for many of our levy payers, especially for small firms. There are also concerns about fairness: that low risk firms end up footing the compensation bill for those running bigger risks, or that the costs are paid by firms who carry out different types of activity. These are among the reasons that the Financial Conduct Authority (FCA) is currently reviewing how FSCS is funded.

I hope that review will identify ways forward that address these concerns and command a wide measure of support. The FCA will shortly publish a discussion paper.

Meanwhile, our responsibilities at FSCS remain to compensate eligible customers in the wider interest of consumer protection, maintain confidence in financial services and give our levy payers as early and as full advance warning of the levy implications as possible.

Consistent with that responsibility, this edition of *Outlook* warns that this year, there is a risk that we may need to raise supplementary levies on general insurers, life and pensions advisers and home finance intermediaries and modestly exceed our approved management budget to meet unforeseen claims handling costs. We will announce final decisions in January, when we will have more information about claims trends and costs. These risks reflect levels of claims and compensation costs that we could not foresee when the annual levies were set in April. They illustrate once again the unpredictability of demands on FSCS.

The high risk of a supplementary compensation costs levy on general insurers arises because of the failure of the Gibraltar-based insurer Enterprise, which occurred in July.

Enterprise had a significant and varied insurance book in the UK of more than 800,000 policies, including around 86,000 motor policies, motor recovery and GAP cover, policies protecting white goods and household products, and insurance protecting building and home improvement work as part of the Government's Green Deal. FSCS has already incurred costs meeting claims arising under these policies since Enterprise's failure and is now meeting further costs to return premiums following the liquidator's decision to disclaim some policies, particularly motor policies.

We expect to pay compensation to Enterprise policyholders of at least £94m. Although we are expecting a significant recovery from the estate of Independent Insurance, this is unlikely to be received in sufficient time to meet these costs (but will be offset against next year's general insurance provision levies in the usual way).

There is also a risk of a supplementary levy on life and pensions advisers, resulting from more rapid growth in claims than we forecast in the Spring. These are claims against advisers, which result from bad advice to move retirement funds out of occupational pension schemes and into SIPPs and then to invest in high risk, unregulated investments within

> "Claims against investment advisers have been significantly lower than we forecast and so we expect a surplus in this class this year of around £60m."

the SIPP. These are complex claims to assess for eligibility and to quantify for compensation.

FSCS has received claims against 171 firms in total; four of those firms account for 73% of the compensation paid. We currently expect to pay just over £136m in compensation in 2016/17 and to incur administrative costs of more than £7m.

We are also forecasting a deficit in the home finance intermediation class, and may also need to raise a supplementary levy on these firms.

As a result of these unforeseen handling costs, FSCS may also need to spend in excess of our approved management budget, but within the reserve allowed for in our Management Expenses Levy Limit (MELL). When fixing the MELL each year, an allowance is made for additional but unforeseen costs. We will also make a decision about this in January.

There is some better news. Claims against investment advisers have been significantly lower than we forecast and so we expect a surplus in this class this year of around £60m. We plan to apply this as a credit to firms in the class, either against next year's levy or to offset any supplementary levy costs, or both.

We recognise that this is unwelcome news for many firms. We have provided this update to allow firms the time to prepare for the possible levies.

LEVY UPDATE

Likelihood of supplementary levy

- 🟢 Lower risk of supplementary levy
- 🟠 Medium risk of supplementary levy
- 🔴 Higher risk of supplementary levy

Funding indicators for six months to 30 September

Class	Status November 2016	Variance to original forecast £m
Deposits (SA01)	🟢	5
General Insurance Provision (SB01)	🔴	(67)
General Insurance Intermediation (SB02)	🟢	18
Life & Pensions Intermediation (SC02)	🔴	(27)
Investment Intermediation (SD02)	🟢	34
Home Finance Intermediation (SE02)	🔴	(18)

We comment below where the variance is material.

Deposits

Deposits (SA01)	Original forecast 2016/17 £m	Latest actuals and forecast 2016/17 £m	Variance £m	Supplementary levy indication November 2016
B/Fwd from 2015/16	(6)	(1)	5	
Claims	(4)	(4)	0	
Recoveries	0	0	0	
Management Expenses	(14)	(13)	1	
Levies	24	23	(1)	
Surplus/Deficit	(0)	5	5	

General Insurance Provision

General insurance provision (SB01)	Original forecast 2016/17 £m*	Latest actuals and forecast 2016/17 £m*	Variance £m	Supplementary levy indication November 2016
B/Fwd from 2015/16	11	27	16	
Claims	(99)	(183)	(84)	
Recoveries	2	4	2	
Management Expenses	(5)	(7)	(2)	
Levies	91	91	0	
Surplus/Deficit	0	(67)	(67)	

The failure of the Gibraltar-based Enterprise Insurance Company plc is the main reason for the rise in our claims forecast for this year. FSCS paid £15m for motor claims within the first four months and expects to pay a further £45m on indemnity claims over the lifetime of the estate, along with an estimated £18m on return of premium motor claims. FSCS also expects to pay an additional £16m on return of premium claims for warranties issued by Enterprise.

The failure at the end of November of Gable Insurance AG, the Liechtenstein-based insurer, will also contribute to a rise in the claims forecast. Gable sold motor, general liability and home owner insurance, as well as some commercial insurance policies, in the UK.

* Figures rounded to nearest million to reflect continuing uncertainty

Enterprise Insurance Company plc

Enterprise was an insurer that passported into the UK from Gibraltar. Its default was triggered in July this year after the Regulator in Gibraltar applied for the appointment of a provisional liquidator.

Enterprise operated through broker networks in the UK. It had more than 800,000 UK policies across a range of businesses.

Motor Insurance

There were around 86,000 UK motor policyholders as at July – including many small businesses such as taxi and courier firms.

Working with the liquidator, we have agreed the handling processes for claims. Within the first four months, FSCS had paid just under £15m for motor claims and preliminary indications are that we may pay a further £45m on these claims.

Much of this will be on third party claims, with most payments being made over the next 18 months. FSCS protects all policyholders for motor third party risks as well as individuals and small firms with an annual turnover of less than £1m for "own damage". Protection is at 100% of a claim's value for third party claims and 90% for own damage.

Warranties

There are also many Enterprise warranty products, possibly over 1 million, a type of insurance often purchased at the point of sale of another product. The cost of these policies ranged from a few pounds to a few hundred pounds.

These policies are likely to be disclaimed by the liquidator. FSCS is able to help policyholders by paying a return of premium as compensation, which can be used to buy replacement cover.

We are also exploring options with brokers to help them find replacement cover for policyholders. This could mean that instead of paying to policyholders the return of premium we may, subject to specific terms, pay that return of premium to a broker where they have arranged replacement cover.

We are working to establish the remaining value of the premiums owed by Enterprise to its customers. The firm itself was heavily dependent upon brokers providing policyholder information, but provisionally we expect to pay more than £16m on these return-of-premium claims for warranties.

Enterprise also has policyholders in other EU countries such as Greece, France and Italy; however because Enterprise is not a UK firm, FSCS protection is only available for risks located in the UK.

General Insurance Intermediation

General insurance intermediation (SB02)	Original forecast 2016/17 £m*	Latest actuals and forecast 2016/17 £m*	Variance £m	Supplementary levy indication November 2016
B/Fwd from 2015/16	10	11	1	
Claims	(9)	(14)	(5)	
Recoveries	0	20	20	
Management Expenses	(9)	(7)	2	
Levies	8	8	0	
Surplus/Deficit	0	18	18	●

* Figures rounded to nearest million to reflect continuing uncertainty

> “The upward trend in claim volumes has continued into 2016/2017, with claims against an increasing number of firms, although the bulk of claims are against a handful only.”

Life and Pensions Intermediation

Life & pensions intermediation (SC02)	Original forecast 2016/17 £m*	Latest actuals and forecast 2016/17 £m*	Variance £m	Supplementary levy indication November 2016
B/Fwd from 2015/16	14	26	12	
Claims	(98)	(136)	(38)	
Recoveries	0	0	0	
Management Expenses	(5)	(7)	(2)	
Levies	90	89	(1)	
Surplus/Deficit	1	(28)	(29)	●

SIPP-related claims

The number of claims has risen by 59% this year.

The claims typically relate to advice given by financial advisers to move funds from existing pension arrangements and invest into non-standard asset classes held within SIPP wrappers. These investments were often high risk and unsuitable for the majority of investors. Some of the non-standard investments seen with these claims included hotel rooms in Caribbean holiday resorts, storage pods and plantations of oil producing trees in Asia.

Inevitably, because of the risks some of these investments failed. Consequently, FSCS is receiving claims about the advice to invest in these products.

FSCS began to receive a large number of SIPP-related claims in 2014/2015. Our experience of SIPP-related claims against advisers has been consistent with alerts previously published by the FCA in connection with the conduct of some firms. The FCA reminded firms advising on the suitability of pension transfers of their obligation to consider both the customer's existing pension arrangement and the underlying investments intended to be held within the SIPP.

A large part of this compensation paid by FSCS, 73%, is attributable to just four firms. However, 167 firms were responsible for the remaining 27%. This suggests that the problem of bad advice about the investment of retirement savings is spread across many more than just four firms and we cannot easily foresee what the eventual volume of claims against these firms will prove to be.

* Figures rounded to nearest million to reflect continuing uncertainty

Investment Intermediation

Investment intermediation (SD02)	Original forecast 2016/17 £m*	Latest actuals and forecast 2016/17 £m*	Variance £m	Supplementary levy indication November 2016
B/Fwd from 2015/16	39	48	9	
Claims	(109)	(78)	31	
Recoveries	11	10	(1)	
Management Expenses	(8)	(13)	(5)	
Levies	94	94	0	
Surplus/Deficit	27	61	34	

We forecast a significant surplus in this class. We plan to apply this as a credit to firms in the class, either against next year's levy or to offset any supplementary levy costs, or both. The surplus arises because claims costs against advisers in this class have been lower than forecast.

Home Finance Intermediation

Home Finance intermediation (SE02)	Original forecast 2016/17 £m*	Latest actuals and forecast 2016/17 £m*	Variance £m	Supplementary levy indication November 2016
B/Fwd from 2015/16	1	(2)	(3)	
Claims	(6)	(21)	(15)	
Recoveries	0	0	0	
Mgmt Expenses	(1)	(1)	(0)	
Levies	6	6	(0)	
Surplus/Deficit	0	(18)	(18)	

Claims numbers in this sector are higher than forecast. We are considering whether to raise a supplementary levy this year. In addition to the rise in the number of claims, there has been a rise in the uphold rate and the average amount of compensation we have paid per claim. In particular, there has been an increase in claims relating to advice to borrow to invest in non-standard assets, including overseas property.

* Figures rounded to nearest million to reflect continuing uncertainty

FSCS

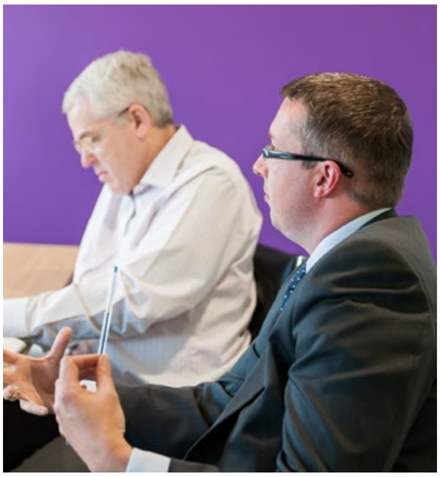
MANAGEMENT EXPENSES

Financial summary for six months to 30 September

Management expenses	YTD Actual £m	YTD Budget £m	2016/17 Forecast £m	2016/17 Budget £m
Core costs*	16.5	17.6	34.0	34.8
Outsourced Claims-handling	6.3	5.5	13.4	10.8
Sub-total	**22.8**	**23.1**	**47.4**	**45.5**
Strategic Change Portfolio	3.9	4.3	10.1	10.1
Total Operations and Investment Expenses	**26.7**	**27.4**	**57.5**	**55.6**
Financing & Major Recoveries Expenses	4.5	5.9	9.9	11.8
Total Management Expenses Levy	**31.2**	**33.3**	**67.4**	**67.4**

The major components of the management expenses are set out above. The latest forecast is for an outturn for the year of £67.4m, in line with the budget set at the start of the financial year.

There is an increase in Core costs for the full year, reflecting the costs of handling Enterprise claims and our expectation that higher volumes of SIPP claims will continue for the remainder of the year. In light of this increasing cost pressure, we may need to spend in excess of our approved management budget, shown above, but within the reserve allowed for in our own MELL. However we have spent less than expected on our financing costs and also certain recovery expenses, such as the costs of recoveries from the legacy bank estates.



* Core costs are those that are central to maintaining FSCS's claims handling capability, to plan for present and future failures, and to deliver other statutory functions and stakeholder requirements.

RECOVERIES

PPI

FSCS has made good progress in its recoveries action against lenders following the Supreme Court's decision in the case of Plevin v. Paragon Personal Finance. Recoveries relate to lender credit agreements, which were the subject of PPI policies that brokers mis-sold to consumers, where the commission paid to the broker was not disclosed.

FSCS has resolved claims with a number of lenders and is actively progressing claims with others since it began the recoveries action in 2015.

2008/09 major bank failure update

As previously reported, FSCS has repaid the loans taken out from HM Treasury for the Icesave, Kaupthing Singer & Friedlander (KSF), Heritable and London Scottish defaults through a combination of recoveries and levies. The final dividend has been received from London Scottish and only a small proportion of the distributions from KSF and Heritable remain to be collected.

FSCS has also made three interim payments totalling £500m, against the liability to contribute to the costs of the resolution of Dunfermline Building Society in 2009. FSCS expects the total Dunfermline liability to be capped at £578m. The final settlement date is still uncertain. We expect to be able to pay the final amount due to HM Treasury from cash balances and other recoveries. This would mean that no further levy would be raised for Dunfermline costs.

The only loan outstanding is for Bradford & Bingley. The capital balance remains at £15,654m. Our latest interest forecast on the loan for the 2016/17 year currently stands at £302m. We expect that this will be levied during the summer of 2017. During the summer of 2016, levies of £337m were raised for the interest accrued during 2015/16. This sum has now been paid to HM Treasury.

As part of the budget on 16 March 2016, HM Treasury announced that it was exploring sales of the Bradford & Bingley mortgages with a view to repaying the FSCS debt owed by Bradford & Bingley, by the end of 2017/18. FSCS has been in discussions with HM Treasury on the prospects for such sales. This would impact on the capital balance outstanding and reduce the interest payable.

POLICY

AND STAKEHOLDER UPDATE

FCA review of FSCS Funding

The FCA launched its review of FSCS funding following recommendations made as part of the Financial Advice Market Review (published on 14 March 2016).

The FSCS Funding Review considers a range of issues including risk-based levies; reforming FSCS's funding classes and whether firms' contributions could be eased by making more extensive use of the credit facility available to FSCS.

FSCS is working closely with the FCA and industry stakeholders on the funding review and looks forward to continuing discussion on the proposals due to be published in the FCA Discussion Paper by the end of this year.

Deposit Guarantee Scheme Directive

On 16 April 2014, the European Union adopted the revised Directive 2014/49/EU on deposit guarantee schemes. The Deposit Guarantee Schemes Directive (DGSD) required a number of changes to be made by both FSCS and industry.

FSCS has been working closely with the with the Prudential Regulation Authority (PRA) and deposit takers on the changes required to firms' single customer view (SCV) files. The extension of eligibility to large corporate depositors as well as other changes is designed to enable effective and prompt payment to depositors. Proposals around these changes and others required by the Bank Recovery and Resolution Directive (BRRD) were covered by the PRA in a number of consultation papers and supervisory statements on depositor protection.

Firms must be compliant with the new requirements and amendments to their SCV files should have been completed by 1 December 2016. FSCS has published guidance for firms on the new rule requirements. FSCS will work with the PRA and deposit takers on the new form SCV files, as part of its ongoing verification process.

The DGSD requires risk-based levies for deposit firms and in September 2016, the PRA published its Statement of Policy: 'Calculating risk-based levies for the Financial Services Compensation Scheme deposits class'. Working with the PRA and FCA, FSCS will implement and collect the risk-based levies for the deposit class as of the 2017/18 levy year.

The DGSD also requires stress tests for deposit guarantee schemes and cooperation agreements between deposit guarantee schemes. FSCS, as a member of the European Forum of Deposit Insurers (EFDI), is pleased to announce it was a founding signatory to the EFDI Deposit Guarantee Scheme Cooperation agreement, approved by the European Banking Authority (EBA). FSCS will work with European counterparts on implementing the arrangements in the cooperation agreement. Going forward, FSCS will also work closely with the EFDI and our European counterparts on stress testing, including issues of cross border cooperation, on which the EBA has also issued guidelines.

Deposit protection limit

As a result of recent changes in exchange rates, the PRA is consulting on whether to increase the limit for savings protection from £75,000 to £85,000, with effect from 30 January 2017.

RAISING AWARENESS OF FSCS

We have achieved 77% awareness of the existence of a scheme or FSCS. We continue with our campaign in print, radio and digital to build our Consumer Awareness programme, targeting specific audiences. We launched a refreshed content programme in October to target women aged 25-35 years. The key objective of the content is to build meaningful awareness of FSCS, by being positive, relevant and most importantly, resonant with their own lives and experiences.

The programme includes a mix of short films and longer features along the theme of 'money hacks': how people can make their money go further, save better, and stay out of debt. As part of the programme, the FSCS microsite has been redesigned. To view the changes, visit www.fscs.org.uk/protected.

Alongside that work, we launched in May a newsletter called Money Means that tackles important personal finance matters for UK consumers. The newsletter covers the wider scope of financial protection that FSCS provides beyond deposits.

The overall objective of Money Means is to increase consumer confidence in financial services and in the protection FSCS provides to consumers. To find out what has been covered in the programme so far and to subscribe, please visit www.fscs.org.uk/moneymeans.

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