



on our way

Annual Report:2000/01
of the FINANCIAL SERVICES COMPENSATION SCHEME



Chairman's Statement

by Nigel Hamilton

This Annual Report is the first published by the Financial Services Compensation Scheme (FSCS), and covers a period both of exciting change and hard, practical preparation towards the establishment of a new structure for financial services compensation. Much work has been done, but much more remains to be done before we become the one-stop shop for all consumers when the Financial Services and Markets Act 2000 is fully implemented later this year on a date known as N2.

It is because we are still in this changeover period that we have called this Annual Report, 'on our way'. We have not just waited for the Act to be fully operational, but have already taken significant strides towards our ultimate goal. From February 2001 we have had operational responsibility for both the Investors Compensation Scheme and the Deposit Protection Scheme. We called that step our 'early start', and it is our belief that it has been handled smoothly and efficiently so that to the outside world it appeared a seamless transition.

FSCS is grateful to the Chairmen, the Boards and executive staff of both these schemes for their helpful assistance in this process. It is our intention that when we bring on the remaining schemes it will be in a similarly smooth and sensitive manner.

Although we have tried to keep the transition as trouble free as possible, it is inevitable that there has been some disturbance for our staff. Our employees have had, for example, to put up with being somewhat disjointedly located, with homes in various locations. But we are finally together in one premises at 1 Portsoken Street, London, and Number One is what we intend to be in the service we intend to provide to our stakeholders. Nevertheless, I should not let this opportunity pass without expressing my gratitude to all the staff for being so resilient, efficient and good humoured throughout.

In such a potentially disruptive period it is important for us to keep focused on why we are being created in our new form. The one-stop shop concept is a great step forward for consumers, regulators, compensation schemes and the financial services industry. It will reduce confusion and duplication, especially for the public, and it is a recognition that we live in a financial world where traditional distinctions between products and product providers have blurred, mixed and matched. What we are doing at FSCS is part of this reality. The amalgamation of the seven compensation schemes also mirrors what is happening both at the Financial Services Authority (FSA) and the Financial Ombudsman Service (FOS).

It is now vitally important that we communicate with the industry and the general public to ensure that they are

clear about our identity and purpose. We also have to work to foster internally a shared philosophy and values. Indeed, one of the reasons for our 'early start' in February was to enhance the development of a single organisation with its own ethos. I believe that in the months that have followed we have seen those aspirations start to bear fruit.

Another important relationship is with the FSA. We have close links with the FSA, but we operate independently. It is my intention that a balanced relationship is developed so that we are, and can be seen to be, accountable to, but separate from, that organisation. It is also important that consumers understand the distinction between what a regulator like the FSA does and what we do in our role as a provider of compensation to qualifying claimants. In future years it is our intention that our Annual Report will contain a number of important features that are not possible in this transition period. For example, we hope to include several case studies that will demonstrate, in very personal terms, what FSCS is doing to help claimants. Simply put, our aim is to provide a first-class compensation service of which both the UK's financial services industry and consumers can be proud, and to spread the word overseas. We already have many international contacts, and feel that we have much to offer and much to learn from the experience of others.

On a personal note may I thank Suzanne McCarthy, our CEO, and her transitional team for their hard work, expertise and effort in getting us this far in such good shape. Thank you all.

This report focuses on what has been achieved so far, and what lies ahead in the immediate future. The new century has brought with it a new approach to the financial services industry, and we are very much part of that. While continuing to bring together, in a very practical way, the existing schemes, we are also looking forward to the challenges ahead. It is clear to all of us at FSCS that we are truly 'on our way'.

The Board

Directors of the Financial Services Compensation Scheme



Nigel Hamilton (Chairman)

Consultant Ernst & Young UK; former Chairman of Corporate Restructuring at Ernst & Young UK; former President of the Society of Practitioners of Insolvency; former member of the Council of The Institute of Chartered Accountants in England & Wales (ICAEW) and past Chairman of the Insolvency Practitioners Committee at ICAEW.



Michael Blair, QC

In independent practice at The Bar; Chairman SFA, PIA and IMRO; Chairman, Review Body on Doctors' and Dentists' Remuneration; formerly General Counsel FSA, General Counsel then Deputy Chief Executive at the Securities and Investments Board; Treasurer of the Bar Council 1995-98.



Graeme MacLennan

Chartered accountant with over 30 years experience in fund management; formerly member of advisory committees on Scottish financial services and committee member at the Association of Investment Trust Companies.



Sarah Brown

Former director of company law at the Department of Trade and Industry; reporting member of the Competition Commission; member of the Friendly Societies Commission.



Suzanne McCarthy (Chief Executive)

Member of the Senior Civil Service; formerly Chief Executive of the Human Fertilisation and Embryology Authority; previous posts held in HM Treasury and Home Office; earlier career as an academic lawyer and solicitor in private practice.



Kenneth Culley, CBE

Formerly Chief Executive of the Portman Building Society; a past Chairman of the Building Societies Association; Director of Fleming Managed Growth plc, Fleming Managed Income plc, Brit Insurance Ltd and Marks and Spencer Financial Services Companies.



Luke March

Chief Executive of Mortgage Code Compliance Board; Non-Executive Director of the Investors Compensation Scheme since 1999; formerly Corporate Governance Director of British Telecommunications; previously Director TSB Bank.



Kit Jebens, CBE

Non-Executive Director of the Investors Compensation Scheme since 1995; Chief Executive of Life Assurance & Unit Trust Regulatory Organisation 1989-1994; previous career in the armed services.



John Young, CBE

Chairman of the Regulatory Board and independent Deputy Chairman of the Council at Lloyd's; formerly director of policy and planning at the Stock Exchange, Chief Executive of the Securities and Futures Authority and then Chief Executive of the Securities and Investment Board; earlier career in institutional stockbroking.

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Chief Executive's Statement

on the way ahead

This year has seen FSCS become a reality. Our aim is to create an organisation that is flexible, proactive, operationally transparent and accountable for its decisions. As illustrated in the Directors' report (pages 14 and 15), FSCS places a high value on having robust corporate governance arrangements in place, and has established two standing committees, the Finance and Administration Committee and the Audit Committee, to monitor and oversee our operations, our systems of internal control and management of risks.

By the end of 2001 we will begin operating as the UK's single financial services compensation scheme. Until then we have a responsibility to work towards the continued success of those current schemes to which we are contributing. Recognising these goals, FSCS has set itself the following key aims for the financial year 2001/02:

- > to ensure that the operational resources we provide to the Deposit Protection Board (DPB) are sufficient and that we assist the DPB, as it may require, in ensuring deposit protection until it ceases to exist at N2;
- > to ensure that our subsidiary company, Investors Compensation Scheme Ltd (ICS), continues to provide a good standard of compensation service to investors until it ceases operating at N2;
- > to work with the Policyholders Protection Board (PPB) in preparation for integration at N2;
- > to work towards creating a unified, company culture;
- > to promote understanding of FSCS;
- > to promote understanding of, and support for, FSCS within the financial services industry;
- > to keep the FSA, to whom FSCS is accountable, informed of FSCS' activities and to work with the FSA;
- > to meet our financial targets and, where possible, to achieve budgetary savings; and
- > to begin the process of evaluation and change, as necessary, of inherited structures, systems, processes and procedures, including the development of relevant performance measures and unit costs.

We forecast that during 2001/02 we will process some 4,200 investment claims and some 50 deposit claims. It is anticipated that the estimated cost of investment compensation for that period will be just under £61m for which a levy has been raised. Deposit compensation payments for the period are currently expected to be between £50,000 to £100,000, and the DPB has sufficient funds to cover this. Following N2 we will, in addition, be dealing with insurance claims which have not been finalised before N2, and claims that relate to insurance defaults declared after that date.

The creation of a one-stop shop will provide value to both consumers and the industry. FSCS recognises how important it is for consumers to understand how we can help when needed. With that in mind, and also to keep all our stakeholders informed, FSCS has created an extensive website (www.fscs.org.uk) giving full information and background about our activities. In addition, during this year we will be producing a number of user-friendly publications explaining our role and how to claim.

Considering our wide remit and the funding provided by the financial services industry, it is vitally important to us that we understand what is happening in the industry and that the industry understands our role and the way we intend carrying it out. For this reason we have established special Industry Committees for each of the three financial sectors - investment, deposit taking and insurance. Each Committee has co-opted members who are experienced industry practitioners.

These Committees will keep the Board informed of developments in their area. In addition, they are responsible for ensuring that their respective industry sectors understand and appreciate the FSCS' role and responsibilities, and will act as conduits and sounding boards for those sectors' concerns. Such information will, for example, help FSCS gauge potential demands for compensation, enabling it to levy effectively.

Throughout the coming year FSCS intends to raise its profile with the financial services industry through meetings and publications. A series of presentations to practitioners on our work will start in July 2001. We plan to begin publishing a regular industry newsletter in the autumn.

Since the Board's appointment FSCS has worked with the FSA in developing the rules and arrangements that need to be in place for the transition to, and thereafter the operation of, the new compensation regime. While independent of the FSA, both organisations recognise the value of good collaboration and consultation on matters of mutual concern, and the intention is for this positive relationship to continue. While less directly related, FSCS and HM Treasury have also formed good links.

From N2 FSCS will have the power to levy regulated firms for the compensation and operational management funds it needs. Until then existing schemes rely, as necessary, on their levying powers to provide the financial resources needed. The basic principle is that regulated firms pay for the compensation costs relating to failed firms within their own sector. As explained in its separate annual report, ICS has announced a 2001 levy of £60.6m to cover its costs and estimated compensation payments for the full financial year 2001/02.

As mentioned in our report, *'early start: report & budget: 2001/02'*, we expect that the FSCS' administration costs in its first full operating year (2001/02) to be around 5% less than the separate DPB and ICS preliminary budgets for the same period due to expected savings in such areas as corporate management. While Scheme costs are, to a large extent, demand driven, we are determined to ensure that we have in place strong financial and operational controls and procedures thereby laying the groundwork for a prudent and efficient organisation. To achieve that we are beginning the process of reviewing our claims processes, assessing our risk management controls, evaluating how we can make better use of information technology and developing performance measures.

To summarise, this year has seen the FSCS Board and staff begin doing their jobs. In our next report we will give a full account of the progress we have made in developing a compensation scheme of which the UK can be proud.



What is the Financial Services Compensation Scheme?

The Financial Services Compensation Scheme (FSCS) will be the new, one-stop compensation scheme for the financial services industry. Created by the Financial Services and Markets Act 2000 (FSMA), FSCS will replace the existing seven compensation schemes¹ when the Act comes into force later this year (at a date known as N2).

The Scheme's role is to compensate eligible consumers in line with the Scheme's rules if any FSA authorised firm (or any European Economic Area (EEA) firm covered by the Scheme) is unable to pay its claims in respect of deposits, contracts of insurance and investment business. In March 2000 the Financial Services Authority (FSA) established FSCS to be the Scheme Manager.

Our Commitment to our Stakeholders

FSCS is committed to meeting its responsibilities to its various stakeholders as follows:

- > **To claimants**: FSCS is committed to providing financial services compensation services of a high quality in the most cost-efficient, timely, approachable and understandable manner;
- > **To our industry stakeholders**: we are committed to fostering good understanding and liaison with our levy payers, and to working proactively with insolvency practitioners in cost-effectively securing redress for claimants, delivering compensation and achieving recoveries from firms in default;
- > **To the FSA**: we are independent, but accountable to, the FSA for the Scheme's operations, and we are committed to working in partnership with the FSA in delivering its objectives, particularly that of consumer protection;
- > **To FSCS staff**: we are committed to providing a supportive, modern working environment based on equal opportunities, visible leadership, open communication, teamwork, well targeted staff development with rewards being tied to achievement; and
- > **To all stakeholders**: we are committed to providing timely, relevant, accessible and accurate information about the FSCS' role and activities and its success in meeting its aims and objectives.

¹ The seven schemes are the Building Societies Investor Protection Scheme, the Deposit Protection Scheme, the Friendly Societies Protection Scheme, the Investors Compensation Scheme, the PIA Indemnity Scheme, the Policyholders Protection Scheme and the Section 43 Scheme.

Making an 'early start'²

The FSCS' directors were appointed by the FSA to deliver financial services compensation from the date of the FSMA's implementation. After extensive discussion and deliberation they decided that it would be right for FSCS to make an 'early start', and begin operating before the Act was brought into force. In coming to that decision FSCS acted to ensure that the high standards currently associated with the provision of compensation were maintained and to achieve, as soon as possible, the benefits both to consumers and the financial services industry of bringing together the different compensation schemes to the extent that this could be done in advance of N2. In addition, it was felt that this move would contribute to maintaining good staff morale and allow the FSCS Board and its Executive to start doing their jobs.

Therefore, on 1 February 2001 FSCS and its employees assumed responsibility for investment compensation. To achieve this ICS became a subsidiary of FSCS. As a result, members of the FSCS Board at close of business on 31 January 2001 took over from members of the existing ICS Board. Thus, in effect, a single enterprise was created.

Unlike ICS, the Deposit Protection Board (DPB) is a statutory body, and therefore a different arrangement was needed. A Service Level Agreement was therefore agreed between FSCS and DPB under which FSCS would provide operational resources for the arrangements for deposit protection (overseen by the DPB).

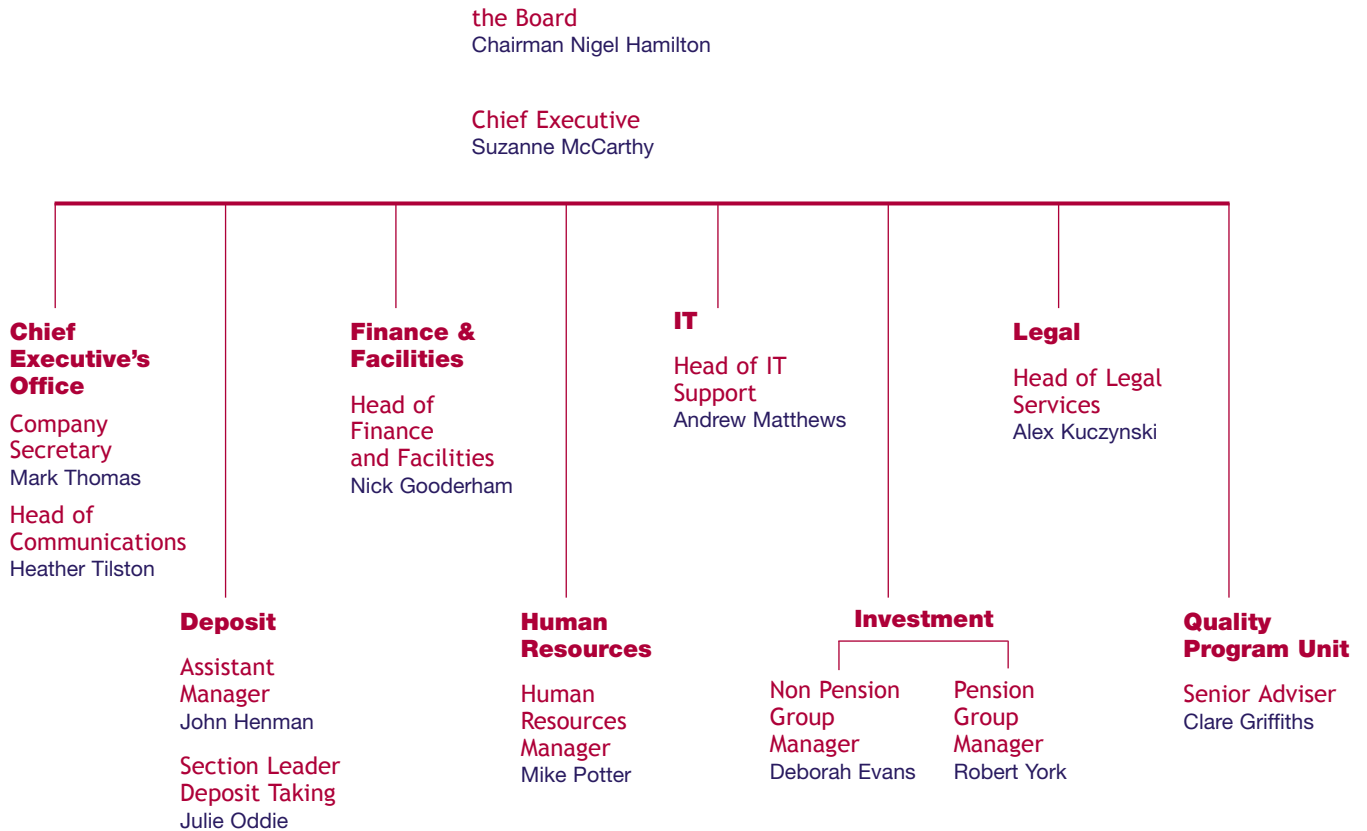
The other 'active' scheme, the Policyholders Protection Scheme, (another statutory body, overseen by the Policyholders Protection Board (PPB)), provides compensation in respect of insurance business written by most general and life insurance companies. A shadow agreement is in the process of being arranged between FSCS and the PPB under which the PPB will agree to share its knowledge and experience with FSCS in preparation for a smooth handover at N2. At that time FSCS will also take on responsibility for four other schemes - the Building Societies Investors Protection Scheme, the Friendly Societies Protection Scheme, the PIA Indemnity Scheme and the Section 43 Scheme. Other than the PIA Indemnity Scheme, these schemes are currently inactive.

Co-Location

On 18 June 2001 FSCS moved to its new premises, 7th floor, Lloyds Chambers, 1 Portsoken Street, London, E1 8BN. It is intended that PPB staff will join FSCS staff in the new premises.

² Full details can be found in the paper, 'early start: report & budget: 2001/02' (FSCS (01)1).

Organisation Chart



Deposit Protection Board and Investors Compensation Scheme

Part of the FSCS 'early start' included assuming responsibility, from 1 February 2001, for providing operational resources for the arrangements for deposit protection overseen by the Deposit Protection Board (DPB). The DPB has published its own Annual Report for 2000/01 which can be obtained by contacting them at the FSCS' address.

Again, since 1 February, FSCS has assumed operational responsibility for compensation in respect of investment business. A copy of the ICS Annual Report is included as a separate document with this report.

Corporate Governance

The FSCS Board has agreed that it will have regard to, and broadly follow, from 2001/02, the provisions of the Combined Code, produced by the Hampel Committee on Corporate Governance in June 1998. Whilst recognising that only UK listed companies are required to report on their compliance with the Combined Code in accordance with the listing rules, the FSCS Board is committed to high standards of corporate governance and, accordingly, decided that it would be appropriate to report on the extent to which FSCS complies.

The Board

The Combined Code indicates that there should be an effective Board to lead and control the company and that there should be a balance of executive and non-executive directors. The FSCS Board currently comprises nine directors, eight of whom are non-executive directors, including the Chairman. The one executive director is the Chief Executive. All directors are appointed by the Financial Services Authority (FSA), using appropriate Nolan principles, transparent recruitment processes and public advertisement. The appointment of the Chairman is also approved by HM Treasury. This appointment mechanism negates the need for FSCS to have a separate nomination committee to advise the Board on prospective new directors. Biographical details of the directors are given on page 4 of the Annual Report. Directors are appointed for periods not exceeding four years, at which time they may be submitted for re-appointment, although the Combined Code recommends that directors submit themselves for re-election at least every three years.

The Board usually meets once a month, and a formal schedule of matters reserved to the Board for decision has been documented and agreed. Some specific areas of Board responsibility are delegated to Committees of the Board or to the Chief Executive, as appropriate. The Board receives and considers reports on all relevant areas of activity to satisfy itself that FSCS is performing its functions satisfactorily and effectively. The Board has also reviewed the supply of information from management to ensure that such information is timely and appropriate.

Directors are subject to a conflict of interest policy to prevent any potential interference with the independence of their judgement on Board matters. They also have access to the services of the Company Secretary, appointed by the Board, who attends all Board and Committee meetings and who is responsible for ensuring that Board procedures are followed. Directors are permitted to obtain independent professional advice, as required, on any matter that might assist them in the furtherance of their duties.

Internal Controls

The Board is developing its arrangements for reviewing the effectiveness of the system of internal controls, which will include considering reports from the Audit Committee on the quality, reliability and effectiveness of the internal and external audit functions, the procedures for risk assessment and management, and the arrangements for control of financial, operational and compliance aspects of the business. As with the Combined Code, the requirements of *'Internal Control: guidance for Directors on the combined code'* (the Turnbull Report) are mandatory only for UK listed companies. However, recognising its responsibilities to ensure that FSCS maintains a sound system of internal control, the Board has decided that it will be appropriate to follow the provisions of the Turnbull Report.

The Board recognises that FSCS has not been able to comply with all the requirements of the Turnbull Report for the full period ending 31 March 2001, but has satisfied itself that measures are in place to make compliance possible in 2001/02.

Corporate Governance

Committees of the Board

1 Finance and Administration Committee

The Finance and Administration Committee meets approximately four times a year, and comprises four non-executive directors and the Chief Executive, as follows:

Nigel Hamilton (Chairman)
Michael Blair
Graeme MacLennan
Suzanne McCarthy
Luke March

This Committee monitors and oversees all operational areas of FSCS. It reports to the Board on key strategic financial and operational issues, and makes recommendations to the Board on areas such as remuneration, the Business Plan, the annual financial statements and levies.

Directors' Remuneration

Remuneration details of directors are given in the Directors' Report on page 14, and in note 5 to the financial statements. Non-executive directors' fees are reviewed annually by the Board as a whole, and are also subject to the FSA's approval. All remuneration matters, including the full remuneration package for the Chief Executive, are considered initially by the Committee and recommendations are made to the Board for approval.

2 Audit Committee

The Audit Committee meets approximately three times a year, and comprises four non-executive directors as follows (with the Chief Executive normally in attendance at meetings):

Sarah Brown (Chairman)
Kenneth Culley
Kit Jebens
John Young

The Committee is responsible for reviewing the annual accounts, the accounting policies, the financial reporting system, the system of internal control and management of risks, the audit processes and the company's procedures for monitoring compliance with laws and regulations and reports to the Board accordingly.

3 The Industry Committees

The Board recognises the importance not only of considering the operational performance of FSCS, but also of being aware of significant developments or events in the financial services sectors. To assist the Board in this it has set up three Industry Committees, one for each of the three main sectors – investment, insurance and deposit-taking.

These Committees aim to meet two to three times a year, to look generally at the flow of work, industry trends and likely future workloads for FSCS in their respective sectors. In order to assist the Committees in their discussions, experienced practitioners have been invited to join as co-opted members. Aside from these members, each Committee comprises three non-executive directors plus the Chief Executive, as follows:

(a) Deposit-taking Industry Committee

Kenneth Culley (Chairman)
Michael Blair
Sarah Brown
Suzanne McCarthy

(b) Insurance Industry Committee

John Young (Chairman)
Nigel Hamilton
Kit Jebens
Suzanne McCarthy

(c) Investment Industry Committee

Kit Jebens (Chairman)
Graeme MacLennan
Suzanne McCarthy
Luke March

Reports and Accounts of Financial Services Compensation Scheme Limited

for the period ended 31 March 2001

Directors' report

The directors of Financial Services Compensation Scheme Limited (FSCS) present their first report, for the period from the company's incorporation on 3 March 2000 to 31 March 2001, together with the audited financial statements of the company for the same period, ended 31 March 2001.

Principal activities

FSCS was formed as the Scheme Manager designate under s212 of the Financial Services and Markets Act 2000 (FSMA) to administer a single compensation scheme for consumers in respect of deposits, contracts of insurance and investment business, should a financial services firm be unable to meet its liabilities.

Review of activities

Since its incorporation and the appointment of directors, the company has made preparations in anticipation of receiving its powers under FSMA at a date referred to as N2 (currently assumed to be no later than 30 November 2001), and integrating the seven existing compensation schemes.

As a part of this process, on 1 February 2001 FSCS became the sole member of Investors Compensation Scheme Limited (ICS), the Scheme Manager responsible for the Investors Compensation Scheme (the ICS Scheme). At that date, the FSCS directors also became directors of ICS.

As a further part of the 'early start' process, staff of both ICS and the Deposit Protection Board (DPB), were offered contracts of employment with FSCS as from 1 February 2001, and FSCS assumed, under a service level agreement, the operational activities of DPB.

Financial position

The company's results show neither a surplus nor deficit as its net costs are treated as recoverable from future participating firms from N2 as costs of establishing the scheme, under s213 of FSMA.

The financial statements of ICS show net assets of £Nil and ICS did not trade during the period to 31 March 2001 as it continued to act in its capacity as Scheme Manager of the ICS Scheme. In accordance with s229(2) of the Companies Act, consolidated financial statements have not been prepared in view of the immateriality of the amounts involved. Financial statements of the ICS Scheme for the year to 31 March 2001 are available from the company secretary, at 7th Floor, Lloyds Chambers, 1 Portsoken Street, London E1 8BN.

Fixed assets

The movements in fixed assets during the period are set out in note 7 to the financial statements.

The directors

Details of the directors for the period to 31 March 2001 are shown on page 4.

Directors' emoluments

Total emoluments paid to directors are as follows:

Period ended 31 March 2001
£'000

Aggregate emoluments	166
Pension contributions	8
	174

The highest paid director, the Chief Executive, received aggregate emoluments in the period of £62,317, and contributions to a defined benefit arrangement under the pension scheme will be made of £7,563. The Chief Executive received no additional remuneration in respect of her role as director.

The fees paid to the Chairman and the other non-executive directors were set at £25,000 and £10,000 per annum respectively, with effect from 17 February 2000. The Chairman and directors, other than the Chief Executive, are not entitled to a pension funded by the company.

Included in the aggregate emoluments of £166,000, which includes VAT on certain fees invoiced by directors, is an amount of £9,792 paid to third parties in respect of the Chairman.

Liability insurance

FSCS maintains insurance to indemnify itself, its directors and its officers against claims arising from the operations of itself and its subsidiary, ICS.

Statement of the directors' responsibilities in respect of the financial statements

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the income and expenditure for that period. In preparing these financial statements, the directors are required to:

- > select suitable accounting policies and then apply them consistently;
- > make judgements and estimates that are reasonable and prudent;
- > state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- > prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors confirm that the financial statements comply with these requirements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable it to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Corporate Governance

A statement of Corporate Governance is contained on pages 11 to 13 of the Annual Report.

Auditors

PricewaterhouseCoopers were appointed as auditors following a competitive open tender process. A resolution proposing the re-appointment of PricewaterhouseCoopers as auditors will be put to members at the Annual General Meeting.

By order of the Board

M Thomas, Secretary, 26 June 2001

Report of the Auditors

Independent auditors' report to the members of Financial Services Compensation Scheme Limited

for the period ended 31 March 2001

We have audited the financial statements which comprise the income and expenditure account, the balance sheet, the statement of cash flow and the related notes.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report.

Basis of audit opinion

We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the affairs of the company at 31 March 2001 and of its result and cash flows for the period then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers,
Chartered Accountants and Registered Auditors, London
26 June 2001

Financial Statements

for the period ended 31 March 2001 (see note 1)

Income and Expenditure Account

	Note	31 March 2001 £'000
Administrative expenses	3	(1,644)
Other operating income		1,644
Service charges receivable	6	601
Recoverable establishment costs	8	1,043
Excess of income over expenditure on ordinary activities before and after tax		-

All the company's operations were continuing. There is no difference between the gains and losses shown above and those prepared under an historical cost basis. There are no recognised gains or losses other than those shown above.

The Notes on pages 20 to 25 form part of these financial statements.

Financial Statements

for the period ended 31 March 2001 (see note 1)

Balance Sheet as at 31 March 2001

	<i>Note</i>	<i>2001 £'000</i>
Fixed assets	7	193
Current assets		
Debtors – recoverable establishment costs: amounts falling due after one year	8	1,043
Debtors: amounts falling due within one year	9	162
Total current assets		1,205
Creditors: amounts falling due within one year		
Bank overdraft	10	(766)
Creditors and accruals	11	(632)
Total current liabilities		(1,398)
Net current liabilities		(193)
Total net assets		–
Accumulated excess of income over expenditure		–

Approved by the Board of Financial Services Compensation Scheme Limited on 26 June 2001.

Nigel Hamilton
Chairman

The Notes on pages 20 to 25 form part of these financial statements.

Financial Statements

for the period ended 31 March 2001 (see note 1)

Statement of Cash Flows for the period ended 31 March 2001

	<i>Note</i>	<i>2001</i> <i>£'000</i>
Net cash outflow from operating activities	13	(573)
Capital expenditure and financial investments		
Payments to acquire tangible fixed assets		(193)
Decrease in cash	14	(766)

Notes to the Financial Statements

for the period ended 31 March 2001

1 Constitution, accounting period and subsidiary

Financial Services Compensation Scheme Limited (FSCS) was incorporated on 3 March 2000 and is a company limited by guarantee. The members of the company are the directors of the company, and liability is limited to an amount not exceeding £1 for each member.

FSCS has been formed as the designated Scheme Manager under s212 of the Financial Services and Markets Act 2000 (FSMA). Its full powers will be assumed following the coming into force of powers of the Financial Services Authority (FSA), under FSMA, which is expected within the financial year to 31 March 2002 (N2 date). In anticipation of its powers at N2, FSCS acquired the Investors Compensation Scheme Limited (ICS) on 1 February 2001 for £Nil consideration. ICS is the current Scheme Manager under the Financial Services Act 1986 with responsibility for compensation for private clients of UK authorised investment firms that have gone out of business, and is a company registered in England.

Financial statements have been prepared for the period from incorporation to 31 March 2001.

The company has one subsidiary, ICS, the financial statements of which show net assets of £Nil. ICS did not trade during the period to 31 March 2001 as it continued to act in its capacity as Scheme Manager and agent to the ICS Scheme. In accordance with s229(2) of the Companies Act, consolidated financial statements have not been prepared in view of the immateriality of the amounts involved. Financial statements of the ICS Scheme for the year to 31 March 2001 are available from the company secretary.

2 Accounting policies

The financial statements have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards.

a Administrative expenses

These costs are included in the income and expenditure account on an accruals basis.

b Pension scheme payments

FSCS operates both a defined benefit pension scheme and a money purchase scheme. The costs of the money purchase scheme are charged to the income and expenditure account as incurred. The costs of the defined benefit scheme are recognised so as to spread the cost of pensions over employees' working lives.

c Fixed assets

Fixed assets are capitalised and depreciated over their estimated useful lives at the following rate:

Building improvements: straight-line basis over the period of the lease, commencing on occupancy.

Notes to the Financial Statements

for the period ended 31 March 2001

3 Administrative expenses

The following amounts are included within administrative expenses:

	<i>Period ended 31 March 2001</i>
	<i>£'000</i>
Auditor's fees	
Audit work	18
Non – audit work:	
Due diligence reviews	76

4 Staff costs

As from 1 February 2001, 91 former staff of ICS accepted FSCS contracts of employment. The average number of employees during the period was 16. At the year end the company had 98 staff comprising 61 permanent and 37 seconded, contract and temporary staff.

Employment costs comprise:

	<i>Period ended 31 March 2001</i>
	<i>£'000</i>
Aggregate gross salaries together with costs of seconded, contract and long term temporary staff	1,116
Employer's national insurance contributions	36
Employer's pension contributions (all defined benefit)	37
	1,189

On 1 February 2001 the pension scheme in the name of the ICS was renamed the Financial Services Compensation Scheme Pension Scheme.

The permanent staff that transferred from ICS to FSCS continued to be members of the FSCS pension scheme. The employer's pension contributions shown above represent the liability to contributions in respect of the service during the period.

The pension scheme offers employees a choice between defined benefits and the pension secured by the individual pension account built up from contributions. It is non-contributory and contracted out of the state scheme. The assets of the scheme are held separately from those of the company.

Notes to the Financial Statements

for the period ended 31 March 2001

The defined benefit pension scheme was valued at 1 April 1999 by a professionally qualified independent actuary on a going concern and a discontinuance basis, the required rates of contribution payable being determined by the actuary. It was assumed that the investment return would be 8% per annum and that the average rate of increase in pensionable salaries would be 6% per annum. The valuation showed that the market value of the pension scheme's assets was £2,523,000 and that in the opinion of the actuary, the actuarial valuation of these assets exceeded the liabilities of the pension scheme by £610,000 at that date. In view of the surplus, the contribution rate paid has been reduced to 11.7% of salaries since 1 April 2000. These contributions include the expenses of running the FSCS pension scheme and the cost of insuring death-in-service benefits.

A pension scheme for new permanent staff from 1 February 2001 is currently being devised. Once finalised these staff members will be given the opportunity to become members of this pension scheme.

FSCS is committed to equality of opportunity for its staff.

5 Directors' emoluments

Details of directors' emoluments are shown on pages 14 and 15 in the directors' report.

6 Service charges receivable

As described in note 4, as at 1 February 2001 all staff of ICS were offered contracts of employment by FSCS and as from that date FSCS has provided staff and resources to carry out the functions of ICS and the ICS Scheme under a letter of agreement. Similarly, as from that date, FSCS has carried out the functions of the Deposit Protection Board (DPB) under a service level agreement dated 1 February 2001. Staff and related costs incurred by FSCS on behalf of ICS and DPB, recharged as service charges, were as follows:

	<i>Period ended 31 March 2001</i>
	<i>£'000</i>
ICS	596
DPB	5
	601

The service charge to ICS includes £34,500 for a proportion of FSCS Board costs since 1 February 2001, which are allocated on a basis of the estimated time spent on ICS matters.

Notes to the Financial Statements

for the period ended 31 March 2001

7 Fixed Assets

	<i>Building improvements £'000</i>	<i>Total £'000</i>
Cost		
Additions in the period	193	193
At 31 March 2001	193	193
Net book value at 31 March 2001	193	193

8 Debtors: recoverable establishment costs

The costs incurred in establishing the single compensation scheme, FSCS, are to be recovered from participating firms over a period of 3 years commencing from N2, currently assumed to be no later than 30 November 2001, and will be invoiced from 2002/03.

	<i>31 March 2001 £'000</i>
Amounts falling due after one year	1,043

9 Debtors: amounts falling due within one year

	<i>31 March 2001 £'000</i>
Prepayments	162

10 Bank loan and facilities

As at 1 February 2001 the company had negotiated facilities for business purposes of £20m, comprising a loan of £6m, and a revolving credit facility of £12m, both repayable over 5 years, at a floating rate of interest based on LIBOR; and an overdraft facility of £2m, renewable in December 2001 at a fixed interest rate above base rate. As at 31 March 2001, £766,000 of the overdraft facility was utilised.

Notes to the Financial Statements

for the period ended 31 March 2001

11 Creditors and accruals

	Note	31 March 2001 £'000
Amount due to the FSA	16	243
Amount due to the ICS Scheme	16	24
Other taxation & social security costs		62
Accruals		303
		632

12 Payments made under lease agreements

The company has commitments in respect of the rental of office space as follows:

Amounts payable in year to 31 March 2002	Leases expiring in:	
	One to two years £'000	Three to eighteen years £'000
Office rental	–	724

FSCS relocated in June 2001. The lease for the new premises at 1 Portsoken St, London, is for 18 years from 13 February 2001 to 21 June 2018, but FSCS has the right to break the lease on 24 June 2012.

There are no assets held under finance leases.

13 Reconciliation of the excess income over expenditure on ordinary activities before interest and tax to net cash outflow from operating activities

The statement set out below relates cash flows to items shown in the income and expenditure account:

	2001 £'000
Excess of income over expenditure on ordinary activities before interest and tax	–
Movements in:	
Recoverable establishment costs	(1,043)
Prepayments	(162)
Other creditors and accruals	632
Net cash outflow from operating activities	(573)

Notes to the Financial Statements

for the period ended 31 March 2001

14 Reconciliation of net cash flow to movement in net debt

	2001 £'000
Decrease in cash	(766)
Opening balance	-
Net cash at end of the period	(766)

15 Analysis of change in cash

	<i>Opening balance</i> £'000	<i>Cash flows</i> £'000	<i>At 31 March 2001</i> £'000
Cash, net of bank overdraft	-	(766)	(766)

16 Transactions with related parties

During the period, the company entered into transactions with the following related parties:

The Financial Services Authority (FSA)
The Deposit Protection Board (DPB)
Investors Compensation Scheme (ICS)

The FSA appoints, and has the right to remove, directors to the Board of FSCS and it establishes the rules under which the scheme will operate as from N2. During the period, the FSA provided short term funding to meet certain establishment costs of FSCS of £986,000 and were repaid £743,000, leaving a balance due by FSCS to the FSA at 31 March 2001 of £243,000.

The FSA is a party to the lease agreement for the Company's premises at 1 Portsoken Street, London (see note 12), as a guarantor of performance of the lease.

Amounts were charged to the DPB and ICS for the 2 months ended 31 March 2001 as a service charge as detailed in note 6. As at 31 March 2001, £5,000 was due from the DPB and £24,000 was due to ICS.

17 Capital commitments

Capital commitments authorised and contracted for but not provided in the financial statements amount to £2.5m.

The outstanding commitments relate to the relocation of the company to 1 Portsoken Street, London. It is intended that these building improvements will be financed through the loan facilities as described in note 10, Bank loan and facilities.

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