



introduction from the Chairman

Welcome to Issue 9 of *OUTLOOK*, which coincides with the publication of our 2004/05 Annual Report. This newsletter provides a summary of the main points.

2004/05 was a year of significant change for FSCS. Mortgage endowment claims continued to arrive at our doors in high volumes. New types of claims, such as "precipice" bonds began to have an impact and we also began preparing for new areas of work that came under our protection - mortgage advice and arranging, and general insurance mediation.

What hasn't changed is our commitment to deliver to consumers and levy payers a service that does what it is supposed to - provide the right level of protection to consumers who need our help, whilst keeping a close eye on costs for our levy payers.

Nigel Hamilton

Investment claims having a big impact

After just a few months as Chief Executive what stands out for me is the enormous variety of challenges being faced by FSCS, in particular the difficulties of forecasting and the pace of change.

More details about the current issues for the Scheme, such as managing rising numbers of claims, forecasting and allocating costs are on page 4.

Despite a backdrop of change, the Scheme kept very firmly in mind its core function - which is to pay compensation to consumers if a firm is unable to pay valid claims.

During 2004/05 we paid out around £174 million in compensation, in respect of 50,000 decisions.

The majority of payments made - almost £113m - related to the insurance sector, for claims against firms such as Independent Insurance and Chester Street.

However, receipt of new claims and payments made in the non-pensions investments area were also significant, with increases in new claims received of 256% and compensation paid up by 293%.

Each claim we handle is looked at on its merits and considered very carefully to make sure it is eligible for compensation under our rules. The average offer rate for an investment claim is 49%. More information about the current uphold rates for different types of claims is on page 3.

The increases in claims have led to some claimants waiting longer for a decision on their claim than we would like.

FSCS has responded to this

increase in work by setting up new, dedicated teams to handle increases in enquiries and investment claims.

We increased our permanent and fixed-term contract staff by just over 41% in 2004/05 and redeployed almost 25% of our staff to new teams.

We have been reviewing the current organisational structure of FSCS to ensure we are as effective and responsive as we can be. Information about this new structure is on page 4.

However, we are now almost at capacity within our current accommodation and recognise that there is a limit to how fast an organisation can and should grow to meet demands. The possible need for expansion is under review.

In the meantime, we are also looking at new and better ways to meet our obligations. For example, we have taken the decision to outsource mortgage endowment claims to help us deal with rising claims.

We are also examining our processes in detail to minimise waiting times and any internal delays, and are continuing to develop our use of technology to enhance productivity.

Our stakeholders rightly expect us to deal with claims quickly, accurately, and at the lowest possible cost. These three objectives can sometimes conflict, and we constantly strive to strike the right balance between them. **LM**



Chief Executive, Loretta Minghella

2004/05 KEY FACTS

Enquiries received:

Telephone: 43,281 - up 75%

Written: 34,897 - up 48%

New investment claims:

11,900 - up 256%

Default declarations: 286

Total compensation paid: £174.71m; 50,000 decisions

Deposits
£0.23m - down 43%

Insurance:
£112.98m - down 14%

Investments:
£14.92m - up 293%

Pensions review:
£46.58m - down 25%

Staff increased by 41%

Levy receipts: £237.64m

Management expenses:
£13.91m

Recoveries: £50.25m

Board of Directors

The Board of Directors is appointed by the Financial Services Authority (FSA). Under the Financial Services & Markets Act 2000 (FSMA), the FSA appoints the Directors on terms which secure their independence from the FSA in the operation of the Scheme. The Chairman's appointment (and removal) is also subject to the approval of HM Treasury. FSCS is independent from the FSA, although accountable to it.

The Chairman and Chief Executive are pictured on page 1. Our other Board members are pictured here and on page 3.

Biographical details are available on our website, (www.fscs.org.uk) and in our Annual Reports.



Sarah Brown, OBE



Terry Connor



Alexandra (Sandy) Kinney

Key facts, figures and trends

Financial

1. Management Expenses

- Our Management Expenses Levy Limit (MELL), set annually after consultation by the FSA, limits the amount FSCS can levy and spend on management costs.
- The FSA consulted on and then approved an increase in our MELL for 2004/05 from £12.5m to £17.6m, to allow us to scale-up our resources in response to significant increases in the numbers of mortgage endowment claims being received.
- Total management expenses for 2004/05 were £13.91m. The lower than anticipated expenditure is due to delayed timing of recruitment and outsourcing costs. These costs will now be incurred in 2005/06.

2. 2004/05 levy collected £237.64m.

2004/05 levies by contribution group

■ Accepting Deposits: A1 - £nil. (FSCS held sufficient funds to cover anticipated compensation payments and management expenses.)	■ Designated Investments: £97.55m
	A7 (Fund managers) £0.10m
	A9 (Managers of AUTs, ACDs & depositories) £0.51m
■ Insurance: A3 (General insurance) - £140.09m. A4 (Life insurance) - £nil. (FSCS held sufficient funds to cover anticipated compensation payments and management expenses.)	A10 (Dealing as principal) £0.28m
	A12 (Brokers holding client monies) £7.19m
	A13 (Brokers not holding client monies) £24.81m
	A14 (Corporate advisers) £0.10m
	IFA Pensions Review £64.56m

3. Total compensation payments amounted to £174.71m. Recoveries receivable amounted to £50.25m.

2004/05 compensation payments by contribution group

■ A1 (Accepting Deposits) £0.23m	■ A12 (Brokers holding client monies) £5.14m
■ A3 (General Insurance) £112.93m	■ A13 (Brokers not holding client monies) £9.74m
■ A4 (Life insurance) £0.05m	■ IFA pensions review £46.58m (formerly A16)
■ A9 (Managers of AUTs, ACDs & depositories) £0.04m	

4. Fund balances at 31 March 2005 amounted to £206.71m.

Deposits: £6.78m; Insurance £136.94m; Investments £12.02m; Pensions Review £51.11m; Mortgage Advice and Arranging £-0.05m; General Insurance Mediation £-0.09m.

The Scheme operates under a pay-as-you-go system. Fund balances are necessary for funding our anticipated out-goings until the next levy date, assumed to be 1 July each year. Some fund balances at 31 March 2005 were higher than expected due to lower than forecast payments in the year, higher recoveries than expected and savings made on management expenses.

5. Total management expenses and compensation payments, recoveries and levies: 1 December 2001 to 31 March 2005.

- Total management expenses and compensation payments from 1 December 2001 - 31 March 2005 amounted to £647.44m.
- Total levies raised from 1 December 2001 - 31 March 2005 amounted to £527.25m.
- Total recoveries received from 1 December 2001 - 31 March 2005 amounted to £211.71m.

Claims statistics¹ 2004/05				
Type of claim	Claims in hand at 1 April 2004	New claims received	Claims completed	Claims in progress and in hand at 31 March 2005
<i>Investments:</i>				
Mortgage endowments	3,300	8,700	3,300	8,700
Precipice bonds	300	2,400	1,200	1,500
Others, inc. splits	250	800	400	650
Total investments	3,850	11,900	4,900	10,850
Pensions review	5,500	3,400	3,900	5,000
Credit unions	60	400	420	40
M&GI firms ²	0	0	0	0
Total claims	9,410	15,700	9,220	15,890
Insurance payments ³	-	41,104	41,104	-

Mortgage endowment claims in hand and new claims received during 2005/06 will be outsourced.

Other investment claims, including precipice bond claims, are being dealt with in-house. The majority of precipice bond claims are being completed within six months and we are working to reduce turnaround times for other investment claims to within six months.

We aim to have largely completed our part of the Pensions Review by the end of 2006.

¹Rounded ²Mortgage and general insurance firms

³Payments only. Insurance claims are handled by the appointed run-off agent and presented to FSCS for checking and payment.

Investment claims

Investments (not including pensions review claims): in total 11,900 new claims were received in the year compared to 3,342 in 2003/04 (an increase of 256%). 4,900 decisions were issued. 49% of decisions resulted in an offer of compensation.

Claims eligibility

Of decisions made, 51% were rejected for one of a number of reasons, for example because:

- a firm was not in default and could deal with claims itself;
- a claim related to business conducted before 28 August 1988 (which is the date when an investor compensation scheme was first established in the UK), which means that the claim is outside of our remit;
- the advice given was compliant, or no compensatable loss was suffered.

The average compensation payment for an investment claim was £6,000.

Decisions by product 2004/05:

- Mortgage endowments - 3,300 decisions were issued. 38% of decisions resulted in an offer of compensation. The average compensation payment was £2,700.
- Precipice bonds - 1,200 decisions were issued. 84% of decisions resulted in an offer of compensation. The average compensation payment was £8,200.
- Other general investment - 400 decisions were issued. 50% of decisions resulted in an offer of compensation. The average compensation payment was £12,000.

The majority of new claims in 2004/05 related to mortgage endowments, but there was also an increase in precipice bond claims as a result of a small number of firms, which sold large numbers of these products, going into default.

Measures have been and are being taken to reduce waiting times and to manage the high volumes of claims that are currently being received.

We will provide more information on claims numbers, and any impacts for our stakeholders, later in the year. (See p4 for more information.)

Pensions Review

Pensions Review: 3,400 new claims were received in the year. 3,900 decisions were issued. 64% of decisions resulted in an offer of compensation. The average compensation payment was £17,000.

Accepting Deposits

Accepting Deposits: 400 new claims were received in 2004/05. 420 decisions were issued. 93% of decisions resulted in an offer of compensation. The average compensation payment was £525.

Insurance

Insurance claims are usually handled by the appointed run-off agent and presented to FSCS for checking and payment. Over 99% of requests for payments are completed within five days. 41,104 payments were made in 2004/05.

Board of Directors

continued



Graeme MacLennan



Richard Pratt



Kate Williams



Christopher Woodburn

Retired from the Board during 2004/05:

Suzanne McCarthy
(Chief Executive)

Tim Vogel
John Young CBE

Retired from the Board since 1 April 2005:

Michael Blair, QC
Ken Culley CBE
Bernard Day OBE

Following a review of our organisational structure, the following structure was implemented from 1 July:

Claims Division:

Ron Devlin is heading up this Division, which brings together all the claims handling work of the Deposits, Insurance, Insurance Intermediaries, Investments, Mortgage Broking, and Pensions teams. This enables us to share best practice and monitor workloads across the Scheme.

Claims Support Group:

Headed by Clare Griffiths, this Group includes the new Default team (which incorporates our previous Insolvency Team), Customer Services and Initial Enquiries Teams. This enables us to co-ordinate all front line activities and first contact with consumers.

Communications Group:

Headed by Heather Tilston, this covers press, public affairs and stakeholder relations.

Finance and HR Division:

Headed by Nick Gooderham, this brings Finance, Payments and HR together.

General Counsel Division:

Headed by Alex Kuczynski, this Division incorporates Legal Services, the Quality Programme Unit, Internal Audit and the Company Secretary function.

Strategic Planning and Operational Support:

Headed by Mike Abbott, this brings together Facilities, IT and Document Management, Process Improvement, Strategic Planning and Performance Measurement.

For more details, visit www.fscs.org.uk.

Key issues for FSCS

Managing claims flow and quality

Ultimately, the key challenges for FSCS are how to forecast and manage fluctuating claims volumes at a reasonable cost and speed, whilst maintaining the quality of our work.

Claims forecasts are fundamental to planning our resource requirements, including how we manage work in progress. They are also key to predicting the likely allocation of claims between different groups of levy payers and therefore the funding requirements in each contribution group.

However, FSCS is in a unique situation. Whilst we monitor trends in the industry, and liaise with FSA and FOS, as a fund of last resort there is not necessarily a direct correlation between claims being received by product providers and live firms, and the numbers of claims that may ultimately fall to FSCS.

For example, it is difficult for us to predict what the level of future business failures is likely to be in any given year. We generally receive only a handful of claims in respect of each of a large number of former authorised firms. Claims tend to come in "off the street", and it is very difficult to judge in advance how many claims may arise in a given period; how many of the firms to which the claims relate will have the means to pay eligible claims themselves, and, if not, what the full consequences will be for FSCS.

There have been a small number of high profile failures which have generated large numbers of claims. In those circumstances, it may be possible to develop a picture in advance of the receipt of actual claims, although even in these circumstances the exact number and value of eligible claims will still be uncertain.

Whilst levy payers are understandably keen for us to provide information as early as possible, being able to forecast accurately the levels of claims that may come to us some months ahead remains difficult. The following areas are currently having an impact on the Scheme:

■ **Endowment claims** - we have already received a significant number of claims in the first few months of 2005/06. It is not clear whether we will continue to receive high levels of claims throughout the year, and we are monitoring any possible trends. We are currently analysing the potential impact for FSCS and exploring different scenarios and potential outcomes, including how many claims we would complete in the year. It is too early to say what the impact on our stakeholders may be. We will provide further information when this has been analysed and will liaise closely with the relevant trade bodies.

■ **Splits claims** - although we indicated in our 2005/06 Plan and Budget that a significant levy for splits claims may be needed, the nature, incidence and likely costs of potential claims were too uncertain to include in our initial 2005/06

levies (announced on 8 April 2005). As has been well publicised, Exeter Fund Managers (EFM), went into administration in March.

The administrators are currently investigating the extent and nature of claims being made against the firm and we are in close contact with them. If it becomes clear that the firm is unable to meet valid claims, FSCS will consider declaring the firm in default. A declaration of default would open the way for claims to be submitted to us. Establishing the financial position of the firm and likely claims will take some time, and we now think it is unlikely that the situation will be clarified until later in the year.

We have, to date, only received a few splits claims relating to firms currently, or potentially, in default.

Whilst a levy for splits claims remains likely, in light of the above we cannot currently say for certain whether a levy for splits claims will be needed this year. We will provide further information as soon as we can.

■ **Precipice bonds, pensions review and other investment claims** - the receipt of claims and uphold rates remain within our forecast ranges. We do not anticipate any fundamental changes to our budget or resource requirements at this time.

■ **Insurance intermediaries** - we have assisted with a few emergency claims relating to Whiteleys Insurance Brokers. We do not currently anticipate a need to raise a levy for compensation payments this financial year, but will keep firms informed if the situation changes.

Forecasts for 2005/06

We will publish more detailed information later in the year about the types and levels of claims we are experiencing, and any identifiable trends going forward. We will keep firms and trade bodies updated on the claims flow and any financial implications.

Allocating costs and levies

To help firms manage their cashflows in the meantime, we were involved in a working group, hosted by the FSA, which resulted in a market solution to allow firms to pay fees and levies by instalments.

The way the costs of claims are allocated under our current rules has sparked debate in the industry. In principle, each sector of the industry pays for the costs of compensation to customers of failed firms in the same sector. This is done by allocating firms in similar lines of business into contribution groups - a matter for the FSA. However, there is room for debate about the structure of those contribution groups and the way costs are apportioned to firms. The FSA will shortly begin its funding review, which we welcome, and we will contribute to that debate.

As the UK's fund of last resort we exist to provide reinsurance to consumers and to help maintain confidence in the sector. However, we keep very firmly in mind that we are funded by levies on authorised firms, and that we must strike a balance between providing the right level of protection to consumers whilst keeping a close eye on costs for our levy payers.