

outlook

News from the Financial Services
Compensation Scheme

Issue 17 | July 2007

Annual Report 2006/07

Claims strategies are paying off

1 December 2006 marked the fifth anniversary of FSCS taking over responsibility for compensation. FSCS has faced many challenges in its first years of operation, particularly in relation to significant and sudden increases in claim numbers and the new types of claims we have had to consider. This has had an impact on consumers in terms of delays in claims handling, and on levy payers because of increased funding requirements.

In our Annual Report for 2006/07 I am pleased to be able to report that FSCS has gone from being inundated with claims to managing significant and fluctuating volumes of claims successfully. 2006/07 is the first year that investment claims completed exceeded new claims received.

We are now delivering on our promises to the majority of consumers who need our help. In the year to 31 March 2007 we processed 86% of endowment claims within our six-month service standard, compared to a target of 90% for 2006/07.

These results show that we have improved our efficiency when dealing with high volumes and 'classes' of claims (for example endowments) although complex claims inevitably take longer.

Although we have more to do to meet our commitments, and want to improve further the service we offer, I believe we are on the right path to becoming a compensation scheme that consistently delivers the service consumers need in a timely and efficient way.

Funding issues

FSCS plays a vital role in maintaining confidence in the financial services sector. A fair and sustainable funding system is essential for FSCS to be able to do its job and to provide the right amount of protection to consumers.

We understand that our levies are often tough news for firms who are being asked to pay for compensation claims that were caused by others, and there are concerns about the fairness and sustainability of the current system. We also recognise that in recent years funding requirements for compensation payments in some parts of the industry, particularly in relation to endowment claims and precipice bonds, have hit some firms hard.

We believe the FSA's proposals to restructure our funding regime will help to increase consumer confidence in the market, improve consumer protection and provide for a fairer and more sustainable method of funding for the future. We particularly welcome the inclusion of a general pool.



**David Hall,
Chairman**

"We are now delivering on our promises to the majority of consumers who need our help."

Photo: David Tothill

Annual Report headlines

- Total claims completed were 31,260, an increase of 21% on 2005/06. 2006/07 was the first year that investment claims completed exceeded new claims received.
- Insurance payments numbered 16,844.
- Total compensation paid was £149.47m.
- Total recoveries received amounted to £39.98m.
- Total management expenditure amounted to £27.18m.
- Total levies raised amounted to £73.10m.

From 1 December 2001 to 31 March 2007:

- Over 73,000 claims were completed.
- Insurance payments numbered 251,738.
- We paid out £958.29m in compensation, including insurance payments totalling £561.35m.
- Levies raised amounted to £737.58m.
- Recoveries received amounted to £360.37m.
- Management expenses amounted to £89.56m.

Download our 2006/07 Annual Report from our website at www.fscs.org.uk

Key facts, figures and trends: Claims and compensation

The FSCS Annual Report and Accounts 2006/07 can be downloaded from our website at www.fscs.org.uk

Summary total claims figures¹:

During 2006/07 FSCS:

- Completed 31,260 claims, compared to 25,800 in 2005/06 – an increase of 21%.
- Received 24,540 new claims, compared to 25,100 in 2005/06 – a decrease of 2%.

Type of claim	Applications received	Claims completed	Claims in hand at 31 March 2007
Investments:			
Mortgage endowments	21,675	25,860	7,290
Others, inc. splits	1,115	1,690	950
Total investments	22,790	27,550	8,240
Pensions Review	683	1,825	200
Credit unions	1,025	1,780	60
GI firms ²	35	100	30
Mortgage advice	7	5	5
Total claims	24,540	31,260	8,535
Insurance payments ³	16,844	16,844	-

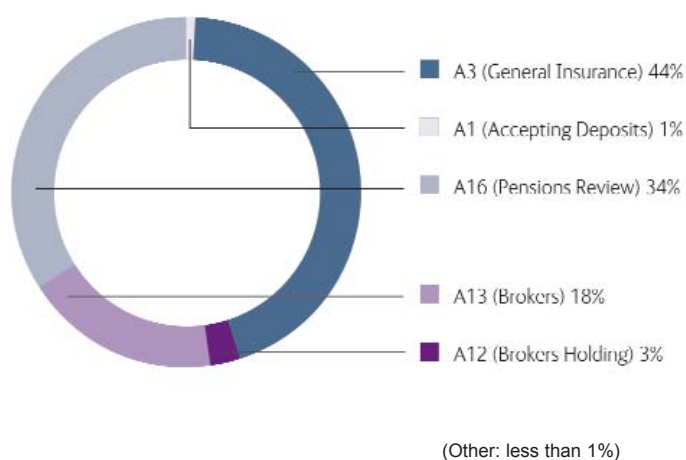
Summary total compensation figures

Total compensation payments for 2006/07 amounted to £149.47m:

- £66.06m: insurance claims
- £50.30m: Pensions Review claims
- £31.80m: investment claims
- £1.21m: deposit claims
- £0.10m: general insurance mediation.

By contribution group:	£m
A1 (Accepting deposits)	1.21
A3 (General insurance)	65.90
A4 (Life insurance)	0.16
A12 (Brokers holding client money)	4.80
A13 (Brokers)	27.00
A16 (Pensions Review)	50.30
A19 (Insurance mediation)	0.10
Total	149.47

2006/07 compensation payments by contribution group



¹ Figures are rounded.

² General insurance mediation.

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

Key facts, figures and trends: Claims and compensation

Investment claims⁴:

➤ 22,790 new claims were received during the year. The majority related to mortgage endowment claims (21,675).

➤ 27,550 claims were completed during the year, a 33% increase on 2005/06 (20,650).

Of these:

- 25,860 endowment claims completed. 45% resulted in an offer of compensation.
- 1,690 other general investment claims were completed. 43% resulted in an offer of compensation.

➤ Average compensation payments:

- £1,900 for mortgage endowments.
- £11,200 for other investment.

Pensions Review:

➤ 683 new claims were received during the year, compared to 2,250 in 2005/06.

➤ 1,825 claims were completed during the year, a decrease of 63%.

➤ 81% of decisions resulted in an offer of compensation.

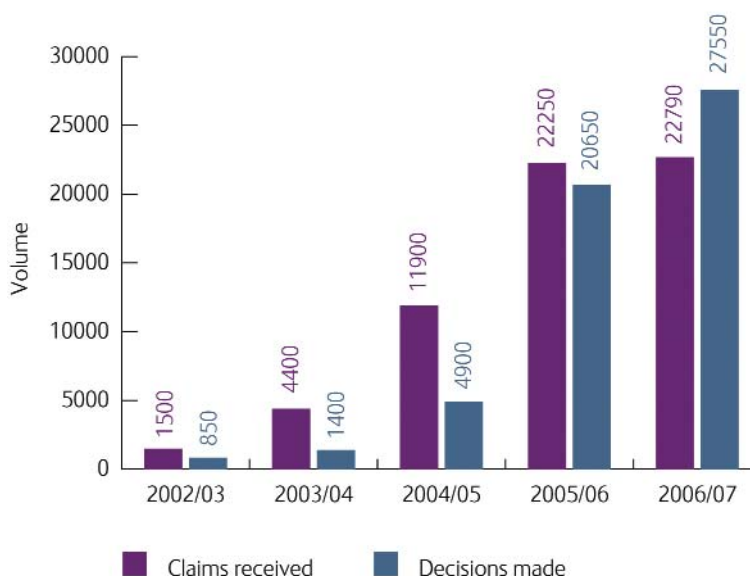
➤ Average compensation payment was £25,000.

During 2005/06, we forecast that we would complete the majority of our Pensions Review work by December 2006. This was substantially achieved in terms of the work then in hand.

However new claims continue to be received, and some claims that were previously referred back to the advising firm have had to be re-opened because the firm no longer has sufficient assets to meet claims.

We now forecast that this work will continue beyond 2007.

Investment claims received and decisions made



Accepting Deposits:

➤ 1,025 new claims were received during the year, an increase of over 300%.

➤ 1,780 claims were completed during the year, an increase of 650%.

➤ 90% of decisions resulted in an offer of compensation, and the average compensation payment was £760.

Insurance:

➤ Insurance claims are usually handled by the appointed run-off agent and presented to FSCS for checking and payment. Requests for payments by bordereaux are usually completed within five days.

➤ 16,844 payments were made.

➤ Compensation payments totalled £66.06m.

Insurance broking:

➤ 35 new claims were received during the year, compared to 364 in 2005/06.

➤ 100 claims were completed during the year, compared to two in 2005/06.

➤ 88% of decisions resulted in an offer of compensation and the average compensation payment was £1,400.

Mortgage advice:

➤ Seven new claims were received and five decisions issued during the year.

No decisions resulted in an offer of compensation.

⁴ Not including Pensions Review.

Key facts, figures and trends: Claims, compensation and financial summaries

Performance against targets

Claims - completion within six-months

Where a firm is in default, FSCS aims to issue a decision on 90% of investment and deposit claims within six months of receiving a completed application form.

- On average over the year 86% of mortgage endowment claims were completed within six months of receipt.
- Of the rest, (including general investment and deposits) 74% of claims were dealt with within six months.

Deposit claims are generally completed within three months. Investment claims over six months old now largely reflect particular complexities or the need to develop new processes to allow appropriate quantification.

Payments within 10 working days

- 96% of payments have been issued within 10 working days of acceptance of an offer. The remaining 4% are related to Pensions Review claims. Of these: 99% of Pension Annuities payments have been issued within 10 working days. Pension Reinstatements are more complex and take longer to resolve.

Responding to consumer enquiries

- In 2006/07, the Customer Services Team's target was to resolve 90% of all telephone calls within 48 hours, which was comfortably achieved each month.

- The team also aimed to resolve 90% of all written enquiries within 20 working days. This was not achieved in the first and last few months of the year due to the exceptionally high volumes of correspondence received at that time. However, following a number of initiatives, this target was achieved from August 2006 to January 2007 inclusive.

Full details of our performance against our published service standards are available in our 2006/07 Annual Report.

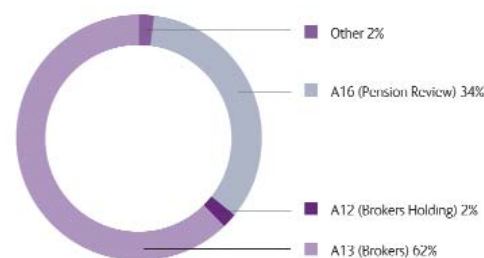
2006/07 Levies

During 2006/07 the levy collected was £73.10m.

By contribution group:	£m
A7 (Fund managers)	0.36
A10 (Dealing as principal)	0.19
A12 (Brokers holding client money)	1.52
A13 (Brokers)	45.67
A14 (Corporate finance advisory)	0.05
A16 (Pensions Review)	24.58
A18 (Mortgage advice)	0.25
A19 (Insurance mediation)	0.48
Total	73.10

Other contribution groups were not levied in the period.

2006/07 Levies by contribution group



Management expenses

- FSCS's Management Expenses Levy Limit for 2006/07 was £37.06m, based on forecast budget expenditure of £29.37m and including a reserve contingency of £7.69m.
- Total actual management expenses expenditure for 2006/07 were £27.18m, and included expenditure of £0.67m in preparation for handling splits claims.

2006/07 Recoveries

During 2006/07 recoveries amounted to £39.98m.

By contribution group:	£m
A1 (Accepting deposits)	0.32
A3 (General insurance)	35.47
A4 (Life insurance)	0.05
A13 (Brokers)	0.07
A16 (Pensions Review)	4.07
Total	39.98

2006/07 Fund balances

As at 31 March 2007 fund balances amounted to £139.09m.

Fund balances

by contribution group:	£m
A1 (Accepting deposits)	4.43
A3 (General insurance)	137.31
A4 (Life insurance)	0.38
A7 (Fund managers)	0.03
A9 (Managers of AUTs)	0.01
A10 (Dealers as principal)	0.02
A12 (Brokers holding client money)	(0.70)
A13 (Brokers)	6.01
A14 (Corporate advisers)	0.03
A16 (Pensions Review)	(9.01)
A18 (Mortgage advice)	0.33
A19 (Insurance mediation)	0.25
Total	139.09

Chief Executive's statement

Photo: David Tothill

Our mission at FSCS is to provide an effective and efficient compensation service. We believe we have achieved a great deal in our first five years of operation, but there is more to do.

2006/07 was the first year in which we published clear service standards and targets against which we could be measured. The results in our Annual Report 2006/07 show that we have achieved many, although not all, of the challenging targets we set ourselves during the year. For full details see Section 3 of our 2006/07 Annual Report.

We are now very much closer to meeting our 90% target for dealing with endowment claims within six months, and have introduced a number of measures to ensure that we respond in a timely and appropriate way when consumers need our help. I hope the results in our Annual Report will demonstrate our commitment to providing an efficient and effective service.

2006/07 was the first year that decisions made on investment claims exceeded new claims received. Whilst dealing with claims is our core function, we are also committed to ensuring that we provide an economic and efficient service to reduce the burden on our levy payers. I am pleased to be able to report that we completed more claims than we originally forecast for the year whilst spending less than originally budgeted. We completed over 31,200 claims in 2006/07 and spent just under £27.2m on management expenses. This compares favourably to our original forecast for the year of completing 28,150 claims and utilising a management expenses budget of £29.37m. Going forward, FSCS is evolving its work on turnaround times, process efficiency and quality to ensure we continue to progress and deliver improvements to our stakeholders in terms of the service we offer and the cost of the Scheme for levy payers.

Although much of our work has focused on dealing with high volumes of endowment claims, other areas of claims have presented new challenges that have tested our claims strategy and ability to deal with new issues, in particular claims relating to split capital investment trusts (splits) and increases in the number of credit union claims. I give an overview of some of the issues we dealt with in 2006/07 on page six.

- Loretta Minghella



Chief Executive, Loretta Minghella

"I hope the results in our Annual Report for 2006/07 will demonstrate our commitment to providing an efficient and effective service."

Download the full Annual Report from our website at www.fscs.org.uk

New Director of Claims for FSCS

FSCS has welcomed Jonathan Clark as its new Director of Claims. He succeeds Ron Devlin, OBE, who retired from the Board at the end of June. Ron had worked for FSCS for nearly six years in roles including Senior Adviser, Interim Chief Executive and Director of Claims. Mr Clark joins FSCS from Crawford & Company where he was Senior Vice President Quality and Compliance. His background is as a chartered loss adjuster and chartered insurance practitioner.

"I am confident that Jonathan will make a major contribution to developing FSCS and will build on the outstanding work done by Ron Devlin during the last six years," says FSCS Chairman David Hall.

- Loretta Minghella, FSCS Chief Executive, has been reappointed as an Executive Director of the Board of FSCS until 30 November 2010.
- Richard Pratt and Kate Williams were reappointed as non-executive Directors of the Board of FSCS for a further two years from 1 June 2007 to 31 May 2009.



Director of Claims, Jonathan Clark

Key issues in 2006/07

- *Loretta Minghella*

Splits claims

At the time of writing we have declared Exeter Fund Managers Ltd (EFML) in default, and BFS Investments plc is likely to be declared in default later in the year. Although splits claims may be complex, we believe our preparations will ensure we can deal with them effectively. We have been working closely with the insolvency practitioners and potential claimants to try to understand the nature and types of claims, taking independent expert advice and talking to industry and consumer bodies on how we plan to tackle some of the issues that have been raised.

We have also been developing bespoke application forms and processes, and engaging outsourcers to help us manage what could potentially be thousands of claims during 2007/08. The mid-point of our claims forecast range is currently 8,000 claims relating to these defaults, although this is only an indicative figure.

Whilst all of this work has of course incurred management costs, we have yet to raise a levy to fund these costs or potential splits compensation payments. We have indicated that the industry should expect a splits levy during 2007/08, when the costs of claims are clearer and we have established to which contribution groups these should be allocated.

Credit unions

For credit union members, we believe the service we have provided has done much to instil confidence in the credit union sector. For example, according to the local media, FSCS "saved Christmas" for members of St Columba's Credit Union in Bradford when it closed its doors "overnight" - the kind of headline that brings into sharp relief the importance of the role FSCS plays. Credit union claims have increased quite significantly this year - we declared seven credit unions in default in 2006/07, compared to one in 2005/06, and dealt with over 1,700 claims in 2006/07, compared to around 230 in 2005/06.

Pensions Review claims

Pensions Review claims have had a bigger than expected impact this year and affect firms in contribution group A16. Although these claims are slowly coming to an end more claims are being received by FSCS than anticipated, albeit in relatively small numbers, and we now expect to receive more new claims in 2007/08 and possibly beyond. For every 40 eligible claims of this type we have been paying around £1m in compensation. This means that a small difference between our forecasts and actual claims received can result in significant additional levy requirements.

During 2006/07 we had a funding shortfall in this group, which meant that we also had to increase our future funding requirements for these claims. We recognise that our funding requirements can often be unwelcome news for many firms, particularly if there are unwelcome surprises. In the light of our experience we have improved our forecasting process and strengthened our resources in the relevant teams. We keep our approach under review to see what lessons can be learned from each forecasting round. However, as many stakeholders recognise, forecasting is inherently uncertain.

Insurance broking

Customers of insurance brokers first came under FSCS protection in 2005. We have seen a small but steady flow of claims, mostly for return of premiums for insurance bought where the broker did not place cover or had failed to pass the premium to the insurer at the time of failure and no arrangements had been made for risk transfer.

Our insurance broking team has to be prepared for almost anything, including emergency claims, but I am pleased to report that many claims are being dealt with by insurers accepting that risk transfer is in place, which means consumers are protected and reduces the burden on our levy payers.

Recoveries

FSCS seeks to make recoveries wherever it is possible and cost-effective to do so, and I am pleased to report that recoveries amounted to almost £40m during 2006/07. Recoveries are used to offset levies and funding requirements in the sector from which recoveries were made.

The majority of recoveries are made from the insolvent insurance estates with which FSCS deals, although we are also proactive in the investment and deposit sectors wherever practical. The recoveries made during the year in the insurance sector, and a slow down in claims payment requirements, meant that no levy was required in the general insurance contribution group during the year.