



“Net” levy set at £28.3m

By David Hall, Chairman

Welcome to this edition of Outlook. It contains important information about the 2008/09 levy, as well as updates on other issues including deposit reform, and Pacific Continental Securities (UK) Ltd (in liquidation).

Levy

I am pleased to report that the FSCS Board has confirmed our initial levy for the 2008/09 year at £131.7m to fund compensation costs and management expenses. This is £0.9m more than the figure published in FSCS’s Plan and Budget 2008/09 in February, due to a projected increase in the cost of splits claims and claims against mortgage advisers. However, the overall bill to the industry has been reduced by £2.4m from the figure of £30.7m published in the FSCS Plan and Budget 2008/09 reflecting the transition to the new funding scheme.

Coming against the backdrop of continuing uncertainty and turbulence in the markets, the levy will bring some good news for firms in some sub-classes in the light of reducing volumes of mortgage endowment and pensions review claims. Both have been high volume areas of our work in the past but now appear to be on a sustained downward trend.

The new funding regime, introduced this month, affects the way we have calculated our levy for this financial year. We estimate that we will have total closing fund balances of some £103.4m across the contribution groups at the end of the financial year. The transitional arrangements for the new funding system mean that all contribution group balances at 31 March 2008, other than those for the Accepting deposit sub-scheme, which are carried into the 2008/09 calculations, will go back to firms as credit or debit notes during the levy process. However, these transitional arrangements and the move to the new funding classes will make direct comparisons with previous levies very difficult.

You will find a full breakdown of the final levy by sub-class in Table 1 on page 3. FSCS has also been active in recent months engaging with the industry and the Tripartite Authorities during the consultation on financial stability and depositor protection. The consultation ends later this month and FSCS will continue to work to make sure that any new system is robust and works for the benefit of consumers and the industry.

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“The new funding regime has been implemented and the ‘net’ levy has been set at £28.3m, £2.4m less than we announced in the Plan & Budget”

David Hall,
Chairman

New year, new funding regime

By Loretta Minghella, Chief Executive

2008/09 is going to be a year unlike any other since FSCS was set up. It is not only bringing continuing uncertainty in the markets but also a new funding system. Our funding regime has been completely overhauled, and this major change will have an impact on firms. There are some winners and some losers, but we believe the new system is a better, more sustainable one that will help to smooth volatility. We also believe that having a well funded, efficient and effective compensation scheme is essential for consumer confidence, which in turn is good for the financial services industry and firms.

Five new funding classes (and related sub-classes) have replaced the 12 previous contribution groups. The five new funding classes are life and pensions; investments; deposit; general insurance; and home finance.

The new regime means that we have produced a levy from a zero base for the first time because the fund balances in the previous contribution groups will be passed back to the relevant firms as credit or debit notes as part of the levy process. In previous years, we would carry forward any positive balances to offset the costs we expected for the contribution groups in the next year.

What this means for the levy is that, although we have a gross funding requirement of more than £131m in 2008/09, the industry will only pay a net levy of about £28m after taking in to account estimated fund balances at the end of March.

Underlying the levy this year is a slowing of the volumes of claims coming in some important areas. Both mortgage endowments and pensions review claims are on a sustained downward trend. These have been key claims areas in recent years.

The main drivers of compensation costs for 2008/09 include insurance claims, the long tail of mortgage endowment claims, splits and a less predictable flow of other investment and deposit claims.

The levy does not include any provision for possible claims against Pacific Continental Securities (UK) Ltd (in liquidation). The potential costs of claims against the firm have been the subject of media speculation with some press comments that the compensation bill could be extremely high. We are working with the liquidators who are still gathering information. FSCS is not yet in a position to gauge the likely volume or value of the claims should the firm be declared in default. As a result, we are taking the same approach as we did for splits and will not levy the industry until we have more information. It is probable that we will have to issue an interim levy for these costs during the year and we will, of course, keep the industry informed of developments. We would expect any levy to fall in the investments class.

The current financial climate, and the possible changes to legislation ahead of us, make it difficult to predict what exactly we will be faced with during 2008/09. However, we continue to improve the quality and speed at which we provide compensation to those who qualify for FSCS protection and remain committed to delivering a high standard of service within the current framework and under any new arrangements.

Table 1 on page 3 compares the proposed final levy and initial indicative figures.



“The main drivers of compensation costs for 2008/09 include insurance claims, the long tail of mortgage endowment claims, splits and a less predictable flow of other investment and deposit claims.”

Loretta Minghella,
Chief Executive

Levy – The key points

- The initial levy for 2008/09 has been set at £131.7m. The total “net” levy the industry will pay is £28.3m.
- FSCS estimates it will receive almost 11,000 new claims in 2008/09 and complete more than 14,000 claims.
- The D1 investments (fund management) sub-class levy has increased to £8.5m from a forecast of £7m, mainly as a result of higher uphold rates and higher costs associated with splits.
- The levy for the D2 investment (intermediation) sub-class levy is £8m, down from £9m in the Plan and Budget.
- The levy for E2 has been set at £1.4m to reflect our latest, slightly higher, forecast for mortgage advisory claims.
- All other sub-class levies confirmed as in the Plan and Budget.
- The volume of claims coming into FSCS is slowing in some important areas. Both mortgage endowment and pensions review claims are on a downward trend.
- The main drivers of compensation costs include insurance claims, mortgage endowment claims (that are slowing), splits claims, and a less predictable flow of other investment and deposit claims.

The impact of the levy on sub-classes

The 2008/09 levy has now been set at £131.7m. Although the overall levy total has increased from the estimate published in this year's Plan and Budget 2008/09, the bill for the industry has been reduced by £2.4m. So, the industry as a whole is better off. But what do the changes mean for different sections of the industry?

The levies for the deposit, general insurance, and life & pensions sub-classes have not changed from the figures published in the Plan and Budget 2008/09, while the levies for the investments and home finance sub-classes have changed marginally. Claims in some areas, which have been historically high, like mortgage endowment claims, have started to decrease; but other areas like splits claims have seen a change with higher uphold rates expected in 2008/09.

The deposit sub-class levy remains as forecast at £5m and means that this is the first year since N2 that the deposit sub-class will actually pay a levy. Previously there has been no need to levy this section of the industry as costs relating to the deposit contribution group came out of the money transferred to FSCS in 2001 from the Deposit Protection Board.

The levy for the investment class has increased by a net amount of £0.5m, reflecting higher anticipated splits costs. The levy does not include any provision for potential claims against Pacific Continental Securities (UK) Ltd (in liquidation). Finally, the levy for the home finance intermediation sub-class has increased by £0.4m because of increased claims relating to mortgage advice.

You can find more information about the transitional arrangements for the new funding system on our website at www.fscs.org.uk/industry/latest_news/plan_and_budget_2008-09/qas/

Table 1 compares the new proposed levy to the levy announced in the Plan and Budget 2008/09.

Table 1

Comparison of proposed final levy and initial indicative figures	Proposed levy	Plan & budget - initial indicative levy	Change: Increase/ (reduction)
Sub-class	£'m	£'m	£'m
A1 Deposit	5.0	5.0	0.0
B1 General Insurance - provision	73.8	73.8	0.0
B2 General Insurance - intermediation	2.0	2.0	0.0
C1 Life & pensions - provision	1.0	1.0	0.0
C2 Life & pensions - intermediation	32.0	32.0	0.0
D1 Investments - fund management	8.5	7.0	1.5
D2 Investments - intermediation	8.0	9.0	(1.0)
E1 Home finance - provision	0.0	0.0	0.0
E2 Home finance - intermediation	1.4	1.0	0.4
Total levy amount	131.7	130.8	0.9
Aggregated credit and debit notes (estimated)	(103.4)	(100.1)	(3.3)
Net new money	28.3	30.7	(2.4)



Table 2 shows FSCS's new claims forecasts for 2008/09 by product type and the number of claims we expect to complete.

Product	New claims	Estimated claims to completed
Mortgage endowments	3,750	5,241
Investments (including precipice bonds and non review pensions claims)	1,200	1,200
Pensions review and FSAVCs	370	411
Deposits	4,250	4,250
Splits	1,000	3,000
Insurance intermediaries	250	250
Mortgage advisors	100	75
Total	10,920	14,427

Consultation on financial stability and deposit protection

The Tripartite Authorities consultation on financial stability and deposit protection closes on 23 April. The results of the consultation will help to shape new legislation that is expected to lead to changes in the compensation framework for FSCS.

We welcomed the consultation document and the proposals that would enable us to respond more quickly in the event of a bank or building society failure.

FSCS has been working closely with the FSA, the Bank of England and the Treasury on the reform agenda throughout the process. The timetable for the legislation is not finalised but it could be introduced during the current session. A lot of work has been going on to listen to the views of industry and consumer groups to make sure that the changes proposed are the right ones.

Our main concern is to make sure that whatever the results are; they are robust and increase consumer confidence in the financial markets.

You can find more information on the consultation at the Treasury web site at: www.hm-treasury.gov.uk/documents/financial_services/financial_stability_framework.cfm

Pacific Continental Securities (UK) Ltd (in liquidation) – An update

Pacific Continental Securities (UK) Limited (in liquidation) went into administration on 20 June 2007 and was subsequently placed into liquidation on 21 March 2008. FSCS is working with the liquidators, Smith & Williamson, to determine the number and value of claims against the firm.

The liquidators are currently carrying out a reconciliation exercise to verify assets held by Pacific Continental Securities (UK) Ltd (in liquidation) on behalf of its clients, including both cash and shareholdings. Until such time as the liquidators have completed this reconciliation exercise and determined the financial position of Pacific Continental Securities (UK) Ltd (in liquidation), FSCS is not in a position to declare the company 'in default' in accordance with our rules.

So far, FSCS has received 236 claims against the firm. Most of the claims relate to mis-selling, and many of them were passed to FSCS from the Financial Ombudsman Service (FOS) when the firm went into administration. If we declare the firm in default, we will contact everyone who has previously made a claim to the liquidators (or previously to the administrators) asking if they wish to make a claim to FSCS. We will keep the industry informed of developments as we make progress. We will make an interim levy if necessary to cover these claims.

Levy trends

Further details of levies for contribution groups by year, from N2 to 31 March 2008, are on our website at www.fscs.org.uk/industry

