

# outlook

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The Newsletter for the Financial Services Compensation Scheme



## from the Chairman

We welcome this opportunity to explain to industry who we are and what we will be doing after our official launch at N2.

1 December will mark the beginning of a new compensation regime for the UK covering deposits, investments and insurance.

We are confident that the new consolidated Scheme will benefit both consumers and industry.

One of our aims is to ensure that relevant and timely information is easily available about our activities, and this newsletter is part of our programme for achieving that goal.

We are always open to suggestions on how we can improve communications with the industry, and we look forward to any comments or suggestions you have for developing this.

If you would like more information about FSCS please visit our website, [www.fscs.org.uk](http://www.fscs.org.uk), or contact our Helpline on 020 7892 7300.

Nigel Hamilton, Chairman

## Welcome to the one-stop Compensation Shop

**On 1 December the finance sector's new one-stop shop for compensation, created under the Financial Services and Markets Act (FSMA), officially starts work.**

FSMA will be implemented at midnight on 30 November.

The Financial Services Compensation Scheme (FSCS) replaces eight existing schemes including the Deposit Protection Scheme, The Investors Compensation Scheme (ICS) and the

Policyholders Protection Scheme.

It is accountable to, but independent from, the Financial Services Authority (FSA) and funded by a levy on authorised firms.

The Scheme acts as a final safety net for consumers who have claims against regulated finance sector firms which are unable to pay them. We cover deposits, insurance and investments.

Arrangements for taking over the work of the existing

compensation schemes are already underway. FSCS made an 'early start' in February 2001 when the ICS became a subsidiary of FSCS and the Scheme began providing operational resources for the Deposit Protection Board.

FSCS also currently has a Shadow Agreement with the Policyholders Protection Board, in advance of taking over their work in December.

We hope this newsletter will help to explain who we are, and our aims for the future.



**Chief Executive, Suzanne McCarthy. Appointed by FSCS in October 2000.**

**Suzanne led the 'early start' by FSCS, and is gearing up for the official launch of FSCS in December. (See back page)**

**"We expect a seamless transition," she says.**

## Where does the Scheme fit in?

**FSA, FSCS, FOS .. we've all got some new abbreviations to get used to, but where does the Scheme fit into the new regulatory world?**

The Financial Services Authority is the new regulator for the finance industry, created under FSMA.

FSMA also created a single Ombudsman Service and a single Compensation Scheme.

The FSCS and the Financial Ombudsman Scheme (FOS) are separate bodies, independent from (but accountable to) the FSA.

FSCS is only triggered if a consumer has a claim against a regulated firm which is unable to pay claims against it (or likely to be unable to pay). In general this is when a firm has gone out of business or is insolvent.

The FOS handles complaints from consumers against 'live' firms - those that are still authorised and trading.

If consumers have a complaint against a firm which is still in business, they should go through that firm's complaints procedures. If the issue is not resolved, they can turn to the FOS to look at the case.

**2 Funding  
- the costs**

**3 Compensation  
- the limitations**

**4 Introducing the  
Committees**

# FSCS board



Michael Blair, QC



Sarah Brown



Ken Culley, CBE



Kit Jebens, CBE



Graeme MacLennan



Luke March



John Young, CBE

The conduct of the Compensation Scheme is the responsibility of its Board of Directors, 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 the Treasury.

FSCS is independent from the FSA, although accountable to it, and, ultimately, to the Treasury.

Board members (from top): Michael Blair, QC; Sarah Brown; Kenneth Culley, CBE; Kit Jebens, CBE; Graeme MacLennan; Luke March; John Young, CBE.

FSCS' Chairman, Nigel Hamilton, and Chief Executive, Suzanne McCarthy, are pictured on page one.

## Why do we exist?

### Promoting confidence and good practice

Our reason for existing is to pay compensation to consumers in the most cost effective way.

We'll compensate consumers if a bank, building society or insurance company collapses.

We'll compensate consumers if they've lost money, for example because they've been given bad advice by an IFA that's now gone out of business, or if an IFA disappears with their clients' money.

We're a safety net - a last resort and a lifeline for many.

But we will also ensure that we recover as much as we possibly can to lessen the burden on levy payers.

The presence of a compensation scheme helps to maintain a sense of confidence in the sector.

Compensation isn't unlimited, consumers have to accept responsibility for their money and the decisions they take.

However, the presence of a compensation scheme promotes financial stability and lessens the risk of a single failure triggering a wider loss of confidence.

We appreciate that levy payers can feel that the good pay for the bad.

But without a compensation scheme, consumer confidence in this vital sector would be threatened.

## How the Scheme

Levy payers, depending upon their regulated permissions, will be allocated to a sub-scheme comprising of contribution groups, similar to the FSA's fee blocks.

These sub-schemes are:

- deposit-taking
- insurance business
- designated investment business.

In broad terms they correlate to the former Deposit Protection Scheme, Policyholders Protection Scheme and Investors Compensation Scheme.

A company could be allocated to one or more contribution groups, and therefore sub-schemes, by virtue of its permitted activities.

The cost structure comprises:

#### Management expenses

These are FSCS' overheads split between base costs and specific costs. All firms contribute to the base costs - the costs of running the scheme.

Specific costs are the cost of assessing claims and making payments. These will be allocated to the relevant contribution group.

The Management Expenses Levy will be subject to an annual limit, contained in annual consultation.

#### Establishment costs

All firms will contribute to their share of establishment costs, which are being spread over three years from March 2002.

#### Compensation payments

Companies within each contribution group will be liable for the related compensation costs. Payments will be based on the contribution group tariff.

Compensation levies are limited by reference to sub-schemes:

**Deposits:** firms pay no more than 0.3% of their protected deposits.

**Insurance** business: 0.8% of the participant firm's relevant net premium income in a financial year.

Designated **investment** business: £400 million in any one financial year.

# Making the Rules

**Under FiSMA, the FSA were obliged to make the Rules for the FSCS. These set out the obligations of the Scheme, types of claim covered, who is eligible for compensation, the amount of compensation payable and how compensation may be calculated.**

FSCS covers claims against firms where they are unable, or likely to be unable, to pay claims against them.

In general this is when a firm is insolvent or has gone out of business. These are described by FSCS as being 'in default'.

The primary aim of the scheme is to provide protection for private individuals, although small businesses are included.

Larger businesses are generally excluded, aside from cover for compulsory and long term insurance policies.

There are limits to the amount of compensation payable.

FSCS will require assignment of rights from claimants which allows FSCS to recover funds both from the firm 'in default' and third parties.

Any recoveries will be paid into the fund from which the compensation was paid.

■ FSCS also assumes responsibility for claims made to pre-N2 schemes that are outstanding at N2.

FSCS will apply the rules of

the pre-N2 schemes, including limits on compensation, to those claims.

Those rules will also apply to claims made after N2 in respect of defaults declared before N2 or arising out of activities which took place before N2.

The assets and funds of the pre-N2 schemes will be transferred to FSCS and held for the benefit of the relevant sub-scheme.

## FSCS will replace

- the Building Societies Investors Protection Scheme,
- the Deposit Protection Scheme,
- the Friendly Societies Protection Scheme,
- the Investors Compensation Scheme (ICS),
- the PIA Indemnity Scheme,
- the Policyholders Protection Scheme,
- the Section 43 Scheme.

*In addition, FSCS will take over Pension Review claims made by spouses and dependents of deceased investors, currently dealt with by the ABI.*

**It is expected that credit unions will be included in the Scheme in the future.**



## The limitations

There are limits to the cover the Scheme provides. Consumers do have to accept they should take some responsibility for their money and the decisions they make. The Scheme is only triggered when a firm is unable, or likely to be unable to pay claims against it.

The maximum levels of compensation are:

- **Deposits** £31,700 (100% of £2,000 and 90% of the next £33,000).

The Scheme is triggered when an authorised deposit taker goes out of business, or is likely to be unable to repay its depositors.

- **Investments** £48,000 (100% of £30,000 and 90% of the next £20,000).

*The Scheme covers two kinds of loss:*

When an authorised investment firm goes out of business and cannot return investments or money.

Loss arising from bad investment advice, or poor investment management.

Investments covered include: stocks and shares;

unit trusts; futures and options; personal pension plans and long-term policies, such as endowments.

### • Insurance

*Long-term insurance* (e.g. pensions and life assurance): 100% of the first £2,000 plus 90% of the remainder of the claim.

*General insurance:* compulsory insurance (e.g. third party motor): 100% of the claim.

non-compulsory insurance (e.g. home and general): 100% of the first £2,000 plus 90% of the remainder of the claim.

Policyholder protection is triggered if an authorised firm is unable, or likely to be unable, to meet claims against it.

**The actual level of compensation paid will depend on the basis of the claim.**

## is funded

Cost/levy type	Levy paying firms	Funding tariff
<u>Base</u>	All firms, through sub-schemes	By reference to firm's FSA fees
<u>Specific</u>	Relevant contribution groups	By reference to the contribution group tariff
<u>Compensation</u>	Relevant contribution groups	By reference to the contribution group tariff
<u>Establishment</u>	As base costs, over three years	As base costs
<u>Pensions review and opt out</u>	Per A16 in CP95	% share of PIA 2001/2 PR levy

## One-stop shop will reduce duplication and increase efficiency

The new one-stop shop will benefit levy payers and consumers, according to FSCS Chief Executive Suzanne McCarthy.

"The creation of a single compensation scheme will reduce duplication and enable us to increase efficiency and cost effectiveness," she says.

"It will also give consumers and the industry a single point of contact and reduce confusion."

By making an early start in February, Suzanne expects a seamless transition from

the old Schemes to the new in December.

"We are already well on our way to creating one Scheme," she says.

"The early start helped to ensure we were fully consulted when the FSA were drafting the Rules and we've begun the process of integrating the existing Schemes.

"It has enabled us to reassure staff, and take a holistic view of how the new Scheme will operate."



# Understanding the industry

One of our main aims is to foster understanding and awareness amongst all our stakeholders.

FSCS has set up three Industry Committees covering deposits, insurance and investments.

Two experienced industry practitioners have been co-opted onto each Committee, and the Committee members may invite other industry experts to advise them from time to time.

### Deposit-taking Industry Committee

Ken Culley (Chairman)  
Michael Blair, QC  
Sarah Brown  
Suzanne McCarthy

Co-opted members:  
Gordon Pell, RBS  
Matthew Wyles, Portman Building Society

### Investment Industry Committee

Kit Jebens (Chairman)  
Graeme MacLennan  
Luke March  
Suzanne McCarthy

Co-opted members:  
Allan Daffern, IFA  
Chris Lyttelton, NCL Investments Ltd

### Insurance Industry Committee

John Young (Chairman)  
Nigel Hamilton  
Kit Jebens  
Suzanne McCarthy

Co-opted members:  
Stephan Pater, Royal & Sun Alliance  
Iain Lumsden, Standard Life

### So what do the Industry Committees do?

- Look at issues affecting industry which could impact on the Scheme.
- Review the flow of work and likely future workload for the Scheme.
- Monitor the Scheme's relationship with levy payers.

If you have a particular issue you would like an Industry Committee to look at, please write to the Committee Chairman at the address below.

# Tell us what you think

## We'd like to hear from you!

Any comments or issues you'd like to raise? Write to Heather Tilston, at:

Outlook, FSCS, 7th Floor, Lloyds chambers, 1 Portsoken St, London, E1 8BN  
e-mail [Heather.Tilston@fscs.org.uk](mailto:Heather.Tilston@fscs.org.uk)  
Fax: 020 7892 7370.

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