

# outlook

News from the Financial Services Compensation Scheme

SPECIAL EDITION | NOVEMBER 2004



## Introduction from the Chairman

Welcome to this special edition of **OUTLOOK**, our newsletter for authorised firms. I welcome this opportunity to explain to mortgage firms who we are and what we do.

31 October 2004 marked the beginning of a new regulatory regime for firms conducting mortgage business. Part of the regime includes the extension of a fund of last resort to your customers - the Financial Services Compensation Scheme (FSCS).

We are confident that the extension of protection will benefit both consumers and industry, by helping to maintain confidence in the industry.

One of our aims is to ensure that relevant and timely information is easily available about our activities. This newsletter is part of our programme for achieving that goal. You will usually receive copies of *Outlook* twice a year.

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

Nigel Hamilton, Chairman

## Mortgage firms:

# An introduction to FSCS

The Financial Services Compensation Scheme (FSCS) was created under the Financial Services and Markets Act 2000 (FSMA) as the single statutory fund of last resort for customers of firms authorised by the Financial Services Authority (FSA).

FSCS can pay compensation to consumers who have claims against authorised firms that are unable, or likely to be unable, to pay them (usually because they are insolvent). FSCS covers deposits, insurance contracts and investment business.

From 31 October 2004 the Scheme also covers mortgage advice and arranging; and from 14 January 2005 it covers business conducted by general insurance intermediaries. (FSCS will only be able to consider claims relating to general insurance mediation that arise from business conducted on or after 14 January 2005, and for mortgage business conducted on or after 31 October 2004).

FSCS is funded by levies on authorised firms. The amount a firm is required to contribute depends on the type(s) of business it is authorised to conduct.

All firms contribute to the running costs (management expenses) of the Scheme. Compensation payments are charged to the contribution groups that give rise to the claims.

For funding arrangements see page 2.

### Mortgage claims

For mortgage business there are two main types of claim that FSCS can consider:

- 1 FSCS may be able to provide compensation to consumers if advice was given to enter into a mortgage agreement that was unsuitable for them and they have lost money as a result.
- 2 If a mortgage adviser becomes insolvent and owes its clients money.

The types of claims that we anticipate will be protected by FSCS are given on page 3.

### Limitations

The compensation payable for mortgage claims is limited to £48,000 (100% of the first £30,000 and 90% of the next £20,000). Other limits apply to different sorts of claims (see page 3 for full details).

FSCS can only pay compensation for financial loss and only if the firm can't pay claims against it. For mortgage business, FSCS will only be able to consider claims for compensation that arise from business conducted on or after 31 October 2004.

## Where does the Scheme fit in?

The Financial Services Authority (FSA) is the regulator for the finance sector, created under FSMA.

FSMA also created a single Financial Ombudsman Service (FOS) and a single compensation scheme, FSCS.

FSCS replaced former

compensation schemes, including the Deposit Protection Scheme, Policyholders Protection Board and the Investors Compensation Scheme.

FSCS and 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, or likely to be unable, to pay claims against it. In general this is when a firm is insolvent.

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

2 | **How the Scheme is funded**

3 | **Claims and compensation**

4 | **Why we exist**



Michael Blair, QC



Sarah Brown, OBE



Ken Culley, CBE



Bernard Day, OBE



Graeme MacLennan



Luke March



Richard Pratt



Tim Vogel



Kate Williams

# How the Scheme is funded

For levying purposes FSCS is split into sub-schemes. Levy payers, depending upon their regulated permissions, are allocated to a sub-scheme made up of contribution groups.

These sub-schemes are:

- accepting deposits
- insurance business
- designated investment business
- mortgage advice and arranging (from 31 October 2004)
- general insurance mediation (from 14 January 2005).

Each sub-scheme contains one or more contribution groups, based on the FSA's fee blocks.

Firms are allocated to a contribution group (or groups) according to their regulated permissions (i.e. the type of business they are authorised to transact).

Only firms within a specific contribution group (or groups) can be levied in respect of compensation payments, and related management expenses, for that type of business.

For example, investment claims are funded by firms with investment business permissions, deposit claims are funded by firms with deposit-taking permissions, and so on.

The cost structure comprises:

### Management expenses

These are FSCS' overheads, split between base costs and specific costs. Base costs represent the fixed costs of the Scheme, before handling cases. All firms contribute to the base cost element of management expenses, by reference to their FSA periodic fee.

Specific costs are the costs of assessing claims and making payments. These will be

allocated to the relevant contribution group by reference to the activity within each group.

The Management Expenses Levy is subject to an annual limit, set after consultation by the FSA.

### Compensation payments

Firms within each contribution group are liable for the related compensation costs. Levies are based on the contribution group tariff (see table below).

### Levy limits

There are limits to the levies FSCS can raise for compensation costs in any one financial year:

**Deposits:** no more than 0.3% of protected deposits (cumulative) in any one financial year.

**Insurance business:** no more than 0.8% of the participant firm's relevant annual net premium income per financial year.

**Designated investment business:** no more than £400 million in any one financial year.

**Mortgage firms:** no more than 0.8% of annual eligible income per financial year.

**General insurance intermediaries:** no more than 0.8% of annual eligible income per financial year.

### When will FSCS raise a levy?

Any levies raised will reflect costs and any anticipated compensation payments.

Compensation payments for claims against mortgage firms are not anticipated to be significant, and any costs in the 'stub' period to 31 March 2005 are expected to be carried forward into the 2005/06 levy. Mortgage firms will contribute to their share of our management expenses from 31 October 2004.

An announcement of our levy requirements will be made in the Spring.

Cost/levy type	Levy paying firms	Funding tariff
Base	All firms, through sub-schemes	By reference to firms' FSA fees
Specific	Relevant contribution groups	By reference to the contribution group tariff
Compensation	Relevant contribution groups	By reference to the contribution group tariff

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



## What kinds of claims will be protected by FSCS?

Within the remit of FSCS, four potential areas of mortgage advice that may give rise to complaints by consumers are:

- Where a consumer has not been advised about the different types of mortgage available to them which resulted in them choosing a mortgage that was not suitable for them. The consumer has suffered a loss as a result.
- If specific details of the mortgage chosen are incorrect, e.g. a longer term has been selected than the consumer had intended or required, and the consumer has suffered a loss as a result.
- If a consumer was advised to switch mortgages but was not given an adequate explanation of why a switch should be made, and the advice to switch mortgages resulted in the consumer suffering a loss.
- If a consumer was advised to take out a lifetime mortgage that was unsuitable for their circumstances at the time and they have made a loss as a result.

FSCS will conduct a full review of the claim in order to establish whether bad advice has been given and to calculate whether the consumer has made a loss. If the advice is not found to have been unsuitable, or if no loss has been suffered, no compensation will be paid.

FSCS will only be able to consider claims for mortgage business conducted on or after 31 October 2004. For the Scheme to be able to pay compensation we are required under our rules to declare a firm 'in default' (see below).

### Default declarations

As the UK's statutory fund of last resort, before FSCS is able to pay claims for compensation we must ensure that the firm against which a claim(s) has been made is not able to pay. Even if a firm is no longer trading it may be able to deal with claims.

The Scheme will declare a firm 'in default' if:

- it has received at least one eligible claim against it, and the customer has made a financial loss;
- FSCS is satisfied that the firm is unable (or likely to be unable) to pay claims against it. This is generally because it is insolvent. FSCS will conduct an investigation to establish this.

FSCS makes regular announcements listing firms recently declared in default by the Scheme.

### Default database

FSCS has a default database on its website. This lets consumers see if a firm they dealt with has already been declared in default. If the firm is not listed FSCS may not have had any claims against it, the firm may be able to deal with claims, its solvency may be under investigation or it may still be trading.

[www.fscs.org.uk/how\\_to\\_claim/default\\_information/](http://www.fscs.org.uk/how_to_claim/default_information/)

# Compensation limits

Under our rules, there are limits to the amounts of compensation the Scheme can pay to a claimant.

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, (such as a bank, building society or credit union) is unable, or likely to be unable, to repay its depositors.

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

FSCS provides protection if an authorised firm is unable to pay claims against it. For example:

- for loss arising from bad investment advice, poor investment management or misrepresentation.
- when an authorised investment firm goes out of business and cannot return investments or money.

Investments covered include: stocks and shares; unit trusts; futures and options; personal pension plans and long-term policies such as endowments.

- **Mortgage advice and arranging:** £48,000

From 31 October 2004 the Scheme will be able to pay up to £48,000 (100% of the first £30,000 and 90% of the next £20,000) for claims against authorised mortgage firms that are unable to pay claims against them.

See opposite panel for details of the types of claim that could be protected.



- **Insurance:**

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

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

- **General insurance: advice and arranging\* :** unlimited, comprising 100% of the first £2,000 plus 90% of the remainder of the claim.

Compulsory insurance is protected in full.

\*For business conducted on or after 14 January 2005.

# Why do we exist?

## Promoting confidence and good practice

FSCS exists to provide a fund of last resort for customers of authorised firms. We provide a lifeline to those most in need of protection.

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

We can provide compensation to consumers who lose money if a bank, building society or insurance company collapses.

We can provide compensation to consumers if they've lost money, for example, because they've been given bad advice by an IFA that has become insolvent, or if a firm disappears with clients' money. From 31 October 2004 that protection is extended to mortgage advice and arranging.

Compensation isn't unlimited, but the Scheme aims to protect those least able to suffer a loss if the worst happens. FSCS will only pay compensation for financial loss, and claims must be eligible under our rules.

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 fund of last resort individual consumers would suffer, and confidence in this vital sector would be threatened.

We also ensure that we make recoveries where possible to lessen the burden on levy payers.

## Consumer guide explains the role of the Scheme

FSCS publishes a short consumer guide, *How we can help*, explaining our role and where we fit in.

If you would like copies to distribute to your customers please contact us for more information.

Copies of the leaflet can be downloaded from our website at:

[www.fscs.org.uk/publications/consumer/](http://www.fscs.org.uk/publications/consumer/)

## Visit us online

Want to know more about FSCS?  
Why not visit our website!

The site includes information for consumers and levy payers and provides electronic versions of all our publications.

You can visit the site at:

[www.fscs.org.uk](http://www.fscs.org.uk)

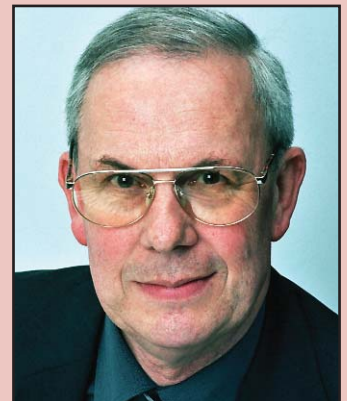
You can also sign up to receive copies of OUTLOOK electronically at:

[www.fscs.org.uk/publications/industry/](http://www.fscs.org.uk/publications/industry/)

## We welcome your feedback

"Feedback from our stakeholders is very important to us," says Interim Chief Executive, Ron Devlin.

"I would encourage you to get in touch if you have any comments about the work of FSCS and how we keep you informed of our activities."



Ron Devlin, Interim Chief Executive

## New Chief Executive for FSCS

The Board of FSCS has appointed Loretta Minghella to the post of Chief Executive.

Loretta is currently the Head of Enforcement Law, Policy and International Co-operation at the FSA. She will take up her position in December.