



Annual Report 2010/11

By David Hall, Chairman

Our work over the past year has been carried out in the wider context of regulatory reforms. Under the Government's proposals, the FSCS will be accountable to both the PRA and the FCA. We think this reflects our important dual roles in resolving failed firms and in protecting consumers.

A key focus of the FSCS Board is on our accountability to the industry which funds us. The failure of Keydata particularly gave a new prominence to that accountability. In late 2010, the FSCS was subject to a Judicial Review after a group of independent financial advisers argued that the compensation costs of the Keydata failure should not be allocated to Investment Intermediaries. However, the High Court ruled that the FSCS had correctly allocated those costs and properly followed the rules.

A cross-subsidy levy was triggered in January 2011 when the FSCS raised an interim levy of £326m on the Investment Intermediaries to pay for the compensation costs of the Keydata failure.

We know that the scale of the Keydata levy presented real difficulties for many businesses and that the industry is keen to see a review of FSCS funding. At present, the FSCS raises levies only in order to pay claims as they arise. Pre-funding would, if adopted, give increased predictability and mean that failed businesses would have contributed to the cost of compensating their customers. But a pre-fund would also mean taking capital out of the industry ahead of any need to meet compensation costs.

The benefits of the FSCS were evident to the four million customers whose deposits were protected following the banking defaults in 2008. The FSCS borrowed money from HM Treasury to safeguard these deposits. Under the terms of the loan agreements, only the interest has been payable. However, from 31 March 2012 we will agree to repay the principal amounts. We are in regular dialogue with HM Treasury about the repayment schedule and keep the industry closely informed of developments.

We are grateful to the industry for its support of our consumer awareness programme, which we launched in January 2011. Although the campaign was well received, there is much more still to be done to raise awareness and we shall refocus our efforts to encourage industry stakeholders to communicate the benefits of the FSCS to their staff and customers.

During 2010/11, we also focused on increasing our ability to respond to volatile events. We invested in our IT infrastructure to meet the requirements of faster compensation payouts and strengthened our operation through developing highly-skilled staff and a robust Board which remains committed to high standards of corporate governance.

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David Hall, Chairman

Chief Executive's summary

By Mark Neale

A responsive service to consumers

Our work in 2010/11 focused on providing an improved service to consumers and the industry as well as developing the organisation to support this. As a result, the year was one of hard work, development and a continuing commitment to providing the best compensation service possible.

We decided over 47,000 claims in 2010/11, and paid out over £535m in compensation. We handled 167,600 enquiries, which is 75 per cent more than 2009/10. Keydata dominated our work in 2010/11. We paid out £214m in compensation to 27,000 claimants.

The FSCS looks for innovative ways to get compensation to the eligible claimants. For Keydata customers who had invested in non-compliant ISAs, the FSCS negotiated with HMRC to pay the tax. This meant the process was faster and less arduous for the investors concerned.

We reached a restructuring agreement with Welcome Financial Services Limited, and arranged for Welcome to act as the claims handling agent on our behalf. The restructuring provides for Welcome to make payments to the FSCS to fund compensation costs, significantly reducing the costs of the default. This arrangement safeguards the interests of levy-payers who will not be levied for the costs of processing claims, while ensuring that consumers get a good outcome.

The FSCS also used its new faster pay-out capability to help resolve three failed credit unions in the first quarter of 2011. The great majority of depositors received payments within our seven-day target.

Minimising costs; maximising recoveries

The FSCS aims to minimise the costs we impose on the industry. Critical to this is our business model which rests on out-sourcing. This enables us to adjust our capacity in the face of fluctuating claims volumes.

The costs of running the FSCS to deliver its 'business as usual' workload in 2010/11 were £37m, compared with a budget of £32.7m. The difference is accounted for by the higher than expected volume of claims we received.

The FSCS has received £756m in recoveries in 2010/11. We also negotiated with the Norwich & Peterborough Building Society full recovery for Keydata claims in which N&P was involved, saving levy payers costs of over £40m.

Preparedness

We invested £18m in new systems to ensure customers of failed deposit-taking firms are guaranteed quick access to their funds. This was £5.6m more than we had budgeted because of the need to improve the underlying Information Technology.

Professionalism

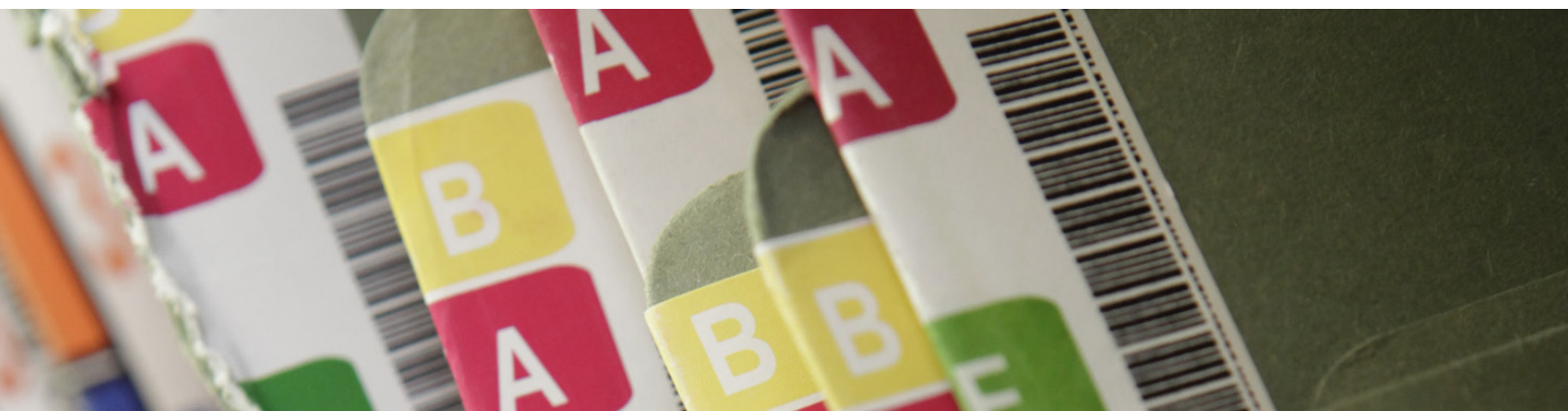
The FSCS will need to broaden its professional skills so that our traditional competence in handling claims is supplemented by capabilities in managing outsource partners, data management, resilience, risk management, project management and many other disciplines.

We will continue to build on the foundations we have laid in 2010/11 so that the FSCS can deliver an improved compensation service to consumers and the industry.

You can read more about our work during 2010/11 in our annual report which is available on our website in a new interactive format.



Mark Neale, Chief Executive



Key points of interest from the Annual Report and Accounts for levy payers

Operating efficiently and maximising recoveries

- The levies we received totalled £919m in 2010/11.
- We made recoveries of £735m from the banking defaults. In total, we have recovered £1.79bn from the failed banks.
- The costs of running the FSCS in 2010/11 were just under £37m compared with a budget of £32.7m. This reflected higher than expected claims during the year. The FSCS also invested £18m in strengthening its capability, particularly a fast payout facility for depositors, compared with a budget of £12.4m.

Refinancing the banking default loans

- Following the defaults of five banks in 2008, the FSCS borrowed money from HM Treasury so as to be able to act to safeguard the deposits of more than four million customers. Under the terms of the loan agreements, only the interest has been payable. Any recoveries have been offset against the principal loan amounts. From 31 March 2012, we will agree to repay principal amounts. We are in dialogue with HM Treasury about the details of the repayment schedule and will update the industry later in 2011 once the repayment terms are finalised.

Responding to consumers

- We received 39,499 new claims in 2010/11. An increase of 25% on 2009/10.
- The failure of Keydata Investment Services Limited and stockbroking firms resulted in 60% of new claims being in the Investment sector. We paid out a total of £214m in compensation to consumers for Keydata claims.
- Payment Protection Insurance (PPI) claims accounted for just over 20% of new claims.

Raising public awareness

- Our campaign ran from January to March 2011. Although well received, the research showed that there is still much to do. We are reviewing the results and planning the next phase of awareness activity, which will call on the industry for further support.
- Our research shows a link between awareness of the FSCS and confidence in financial products.

Being ready to respond

- The FSCS successfully put in place on time, by 31 December 2010, a capability to pay out the majority of depositors in a failed bank, building society or credit union within a target of seven days; and all depositors within a target of 20 working days.

Enhancing our capability

- We are building on in-house and outsourced capabilities to help manage the fluctuating volumes of claims while retaining key skills to deal with complex defaults.



Claims - Key Facts & Figures

The claims figures here are broken down by class and sub-class. There is more information on claims figures in Section 6: Operating effectively and maximising recoveries in the Annual Report and Accounts.

A summary of claims figures

	New Claims Received		Total Decisions	
	2009/10	2010/11	2009/10	2010/11
Deposit	1,112	3,231	1,105	3,127
General Insurance Intermediation	2,513	8,102	1,831	7,875
Life & Pensions Provision	4	2	4	2
Life & Pensions Intermediation	3,427	4,180	3,433	3,573
Investment Fund Management	65	24	124	21
Investment Intermediation	24,301	23,603	15,188	32,196
Home Finance Intermediation	170	357	117	261
Total	31,592	39,499	21,802	47,055
General Insurance Provision	See note		14,958	10,400

** Insurance claims are usually handled by the appointed run off agent and then presented to the FSCS for checking and payment.*



Deposit class

(excluding the banking defaults and Dunfermline Building Society)

The majority of claims in the Deposit class during 2010/11 came from credit unions. Eleven credit unions were declared in default, compared with eight in 2009/10.

- 3,231 new claims were received in 2010/11, compared with 1,112 in 2009/10.
- 3,127 claims were completed in 2010/11, compared with 1,105 in 2009/10.
- More than 97% of claims resulted in an offer of compensation, slightly higher than 93% in 2009/10.
- The average compensation payment for this class was £551.13.
- Where a firm was declared in default before the end of 2010, more than 89% of claims received were completed within eight weeks of receipt, higher than 85% in 2009/10.

100% of claims that were eligible for the seven-day payout were completed within that timeframe.

General Insurance Provision sub-class

There were 10,400 compensation payments in 2010/11, a substantially lower number compared with 2009/10 when there were 14,958. Compensation payments totalled £61.65m compared with £59.77m in 2009/10.

- The largest spend was for claims on employers' liability insurance policies issued by Chester Street Insurance Holdings Limited. The compensation costs of this estate for 2010/11 stand at £39.5m, which is marginally higher than £39.1m in 2009/10.
- The relatively small increase in total spend from £59.77m in 2009/10 to £61.65m in 2010/11 is due to an increase in the Independent Insurance Company Limited compensation costs when compared with the previous year.
- The number of payments decreased in 2010/11, due to the fact that 2009/10 had included exceptional 'catch-up' payments for Chester Street legal defence costs.

General Insurance Intermediation sub-class

The FSCS has seen a steady increase during 2010/11 in PPI claims, while the number of non-PPI claims remains low.

The FSCS has also looked at the overall process for handling PPI mis-selling claims and we have made several changes with the aim of making the process clearer for the claimant. We expect the clearer processes to result in a faster turnaround time from application to decision for the majority of claimants.

- 8,102 new claims were received in 2010/11, compared with 2,513 in 2009/10.
- 7,875 claims were completed in 2010/11, compared with 1,831 in 2009/10.
- Of the total number of new claims received, 8,001 related to PPI. Of these, 1,520 related to one firm, Picture Financial Services Plc, and 220 related to Welcome Financial Services Limited.
- 101 of new claims received were other types of Insurance Intermediation claims, compared with 102 in 2009/10. These included claims relating employers' liability and home and motor insurance. Of the non-PPI claims, 90% resulted in an offer of compensation. The average compensation paid was £1,893.
- Of the PPI claims, 7,772 were completed and 86% of claims resulted in an offer of compensation. The average compensation paid was £5,261.

Life and Pensions Provision sub-class

There were no claims during 2010/11.

Life and Pensions Intermediation sub-class

This sub-class mainly comprises Mortgage Endowments, Pensions Review and Free Standing Additional Voluntary Contribution claims (FSAVCs) and other types of Life and Pensions claim. We saw about 750 more claims in this sub-class during 2010/11, compared with 2009/10.

- 4,180 claims were received during 2010/11, compared with 3,427 in 2009/10.
- 3,573 claims were completed during 2010/11, compared with 3,433 in 2009/10.
- 52% of claims resulted in an offer of compensation.
- The average compensation payment was £8,511.

Investment Fund Management sub-class

Claims in the Investment Fund Management sub-class relate to Split Capital

Investment Trusts (splits) and are now at very low volumes. Some splits claims also fall into the Investment Intermediation sub-class (SD02).

- 24 claims were received during 2010/11, compared with 65 in 2009/10.
- 21 claims were completed during the year as the splits workstream comes to an end, compared with 124 in 2009/10.
- 43% of claims received an offer of compensation.
- The average compensation payment was £7,962.
- 62% of completed claims were within the agreed service standard. This was because we had to process a number of older and more complex claims which required a significant amount of work to bring to a conclusion.



Investment Intermediation sub-class

Much of our overall workload during 2010/11 involved high volumes of claims arising from defaults in this sub-class, many of which presented complicated issues which the FSCS needed to resolve, particular with regard to Keydata. Claims against Keydata accounted for the largest proportion of new claims in 2010/11, resulting in 18,355 new claims.

- 23,603 claims were received during 2010/11, compared with 24,301 in 2009/10.
- 32,196 claims were completed during 2010/11, compared with 15,188 in 2009/10.
- This significant increase in completions during 2010/11 was due to the FSCS being able to resolve a significant number of claims received towards the end of 2009/10 in respect of Keydata.
- 90% of claims resulted in an offer of compensation.
- The average compensation payment was £9,910.
- 97% of claims met the service standard.

Home Finance Provision sub-class

There were no claims during 2010/11.

Home Finance Intermediation sub-class

We continued to see a steady (but slow) increase in the number of new Home Finance Intermediation claims in 2010/11, but the overall number remains low.

- 357 new claims were received during 2010/11, compared with 170 in 2009/10, an increase of 110%.
- 261 claims were completed during 2010/11, compared with 117 in 2009/10, an increase of 123%.
- 23% of claims resulted in an offer of compensation.
- The average compensation payment was £4,949.
- Claims are expected to continue to increase in volume in 2011/12.

Update on Keydata

The year was dominated by the claims arising from the default of Keydata in the Investment class. By March 2011 we had handled over 18,000 such claims, highlighting how important our role is in maintaining confidence in the financial services industry when there is a high-profile failure.

In 2010/11 the FSCS dealt with three main categories of claims relating to Keydata, all three categories had complexities to resolve and all required different approaches. The FSCS worked on an innovative solution for the payment of the 'tax claims' that were termed Category Two. In order to efficiently compensate over 10,000 consumers for the tax liability they now owed, the FSCS paid the tax liability direct to HMRC, saving claimants time and anxiety. A breakdown of Keydata claims by category can be found in Section 6: Operating Efficiently and Maximising Recoveries in the Annual Report.

Just after the end of the financial year 2010/11, we announced that the Norwich and Peterborough Building Society (N&P) would pay recoveries to the FSCS in respect of the compensation we paid to their customers who had invested in products from Keydata Investment Services Limited (Keydata). We have received a recovery of £28m, which is not included in the recoveries figures for 2010/11 since it did not fall within the financial year. In total, this will save levy payers compensation costs of over £40m.

The FSCS will continue to pursue recoveries wherever reasonably possible and cost effective to do so, and we are confident that we will receive more recoveries in relation to Keydata.

Update on faster payout and SCV

During the year a major focus of our work was on developing systems and processes to pay compensation quickly when a deposit taker (such as a credit union) fails.

The FSCS has dealt with three failed credit unions since 1 January 2011, when the timescale for dealing with a deposit claim reduced to 20 working days, but we introduced our own target to complete the majority of claims within seven days. The three credit union failures accounted for one-third of new claims within the Deposit class during 2010/11. We are pleased to report that following the defaults of three credit unions in the first quarter of 2011; nearly all eligible claimants were paid within seven days – many within 48 hours or less.

More recently we have dealt with the first bank failure since the introduction of faster payout, the Southsea Mortgage and Investment Company Ltd. The bank failed on a Thursday morning and the vast majority of people were sent compensation payments on the Friday, with the remainder being paid within 20 working days.

Our programme of meeting with trade bodies

The FSCS works closely with all the trade bodies on issues or trends that could impact on the industry or the FSCS. We meet with trade bodies four times a year. This reflects our commitment to engaging with our stakeholders and listening to their views. The meetings are a useful way of sharing information and can be used by firms to communicate information to the FSCS of which we should be aware. The meetings are scheduled to coincide with the Plan and Budget in late January, the levy announcement in late March, the Annual Report and Accounts in June and the FSCS's half year figures in October.

Our work on and with CMCs

The FSCS is seeing an increase in the number of claims coming from Claims Management Companies (CMCs), particularly in relation to PPI claims. Consumers do not need to use a CMC to have their claim considered by the FSCS and the FSCS does not charge individual consumers for using its service. The FSCS has been working with the FSA, FOS and the Claims Management Regulator (the Ministry of Justice) to produce a joint update for consumers and financial businesses on the role of CMCs. This communication will outline the different roles of the FSCS, the FSA, FOS and the Claims Management Regulator.

Regulatory reform

The FSCS's work continues to be carried out in the wider context of regulatory reform in the UK. Establishing the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) will bring new and focused accountabilities to the work of the FSCS because of our key dual roles in resolving failed firms and protecting consumers.

The FSCS will remain a single independent body, providing compensation across the full range of financial services.

