

Endowment claims flood in to FSCS

The Financial Services Compensation Scheme (FSCS), the UK's financial statutory fund of last resort, has reported the receipt of unprecedented numbers of endowment claims in the first six months of the financial year 2005/06. Nearly 10,000 new endowment claims were received by FSCS between April and September 2005, compared to a January forecast of 7,000 for the full year (1 April 2005 – 31 March 2006). FSCS now estimates that as many as 22,000 new endowment claims will be received during 2005/06.

Commenting on the figures, Loretta Minghella, Chief Executive of FSCS said:

“New endowment claims have been received at unprecedented levels, way beyond our expectations. As ever the challenge for FSCS is to strike the right balance between providing an efficient and timely service to consumers with our responsibility to the industry to keep costs under control.”

FSCS is increasing its resources in house and extending its use of outsourcing to enable it to process higher volumes and to bring claims processing times down.

“The measures we are taking should mean that, where a firm has been declared in default, the overwhelming majority of claims currently lodged with FSCS will have been dealt with by July 2006. Any consumers facing immediate hardship are prioritised,” says Loretta Minghella. “Our claims handling strategy also aims to ensure that, from now on, new endowment claims we receive will be dealt with within our general six months target¹.”

FSCS now expects that it will need to complete around 15,000 claims during the year – as opposed to an original forecast of 7,000 – and will need to use significantly more funds to enable it to process and pay higher claims volumes. It does not, however, currently expect to raise a further levy to fund the additional compensation costs and payments in 2005/06.

¹ Six months from receipt of a completed application form or declaration of default, whichever is later.

Although FSCS does not currently intend to raise an additional levy, it does anticipate an overall shortfall in funds available for these claims: this impacts on firms in the A13 contribution group (investment advisers not holding client money). FSCS expects to be able to carry any shortfall in the A13 group forward to 2006/07 levies, but it is also warning that it expects to be handling similar levels of endowment claims in the next financial year.

The FSCS Board have agreed that for a shortfall of between 10 – 25% of the initial levy (£37.4m) raised on firms in A13 during 2005/06, the need to raise a levy would be kept under review, although it would be unlikely. This range equates to between approximately £4m and £10m. For a shortfall above 25%, it is likely that a levy would be necessary. A levy would not be raised for a shortfall below 10%. FSCS is currently forecasting that the shortfall will be within the 10 – 25% range.

“We do not currently think it is necessary to raise a further levy for endowment claims in this financial year. However, we are keeping a close eye on the level of funds available. There may come a point where a levy has to be raised,” said Loretta Minghella.

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Full details are available in the latest edition of FSCS’s industry newsletter, Outlook, published today. Copies can be downloaded from www.fscs.org.uk

KEY POINTS FROM ISSUE 10 OF OUTLOOK:

- **Endowment claims:** 10,000 claims have been received in the first half of 2005/06. FSCS is now forecasting that around 22,000 new claims could be received during 2005/06. The uphold rate for endowment claims is steady at 39% whilst the average compensation payment per claim has fallen from £2,700 to £2,300 per claim.
- **Precipice bonds:** claims have been received at a lower rate than expected. FSCS is now forecasting that it will receive 2,000 new precipice bond claims this year, as opposed to 2,700. The uphold rate has increased slightly to 88%, whilst the average payout has fallen from £8,200 to £6,800.
- **Pensions review:** although slightly more claims have been received than expected, FSCS is on target to complete its part of the Pensions Review by December 2006.
- **Splits claims:** to date no significant levels of splits claims have been received and FSCS does not now expect to levy for these claims during 2005/06. FSCS is working with the administrators of Exeter Fund Managers to establish the likely volumes of claims against this firm that may ultimately need FSCS protection. FSCS still anticipates that a significant number of splits claims will need to be dealt with by the Scheme. It will publish more information about the situation in February.

- **Insurance brokers:** to date FSCS has only been involved with two failures in the insurance broking sectors, Whiteley Insurance Consultants and BPS Insurance Brokers, with no major claims falling to FSCS so far. It is unlikely that a levy for compensation payments will be necessary in this financial year.
- **Insurers:** FSCS continues to audit the work of run-off agents for the major insurance estates such as Independent and Chester Street, and continues to make substantial recoveries in this sector as further dividends are paid. Since N2 the FSCS has recovered over £261m from insolvent firms, mainly from the insurance sector. To date £48.5m has been recovered this year in this sector and we are now expecting a further significant dividend from the KWELM estate. FSCS is not expecting that a further levy for compensation payments will be necessary in this financial year.
- **Forecasts for 2006/07:** FSCS will be publishing its Plan and Budget in early February 2006, with its forecasts for possible levy amounts and claims numbers for 2006/07.
- **Funding review:** The FSA announced a review of the funding of FSCS in May 2005 and has appointed Oxera Consulting Limited to conduct a detailed analysis of the overall funding requirements for FSCS and the impact of funding arrangements on firms and sectors of the industry. FSCS is playing an active part in the review. The FSA is expected to publish a discussion document in February 2006.
- **Limits review:** An FSA consultation paper that considers the compensation and eligibility limits for FSCS and the Financial Ombudsman Service (FOS) is expected in December.

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NOTES to editors:

The Financial Services Compensation Scheme (FSCS) is the UK's statutory fund of last resort for customers of authorised financial services firms. This means that FSCS can pay compensation if a firm is unable, or likely to be unable, to pay claims against it. FSCS is an independent body, set up under the Financial Services and Markets Act 2000 (FSMA). It protects deposits, insurance, investments, and mortgage business. The service is free to consumers.

FSCS is funded by levies on authorised firms – those that are regulated by the UK's independent financial watchdog, the Financial Services Authority (FSA).

For levying purposes FSCS is made up of contribution groups. Firms are allocated to contribution groups depending on the type of business they are authorised to conduct. Levies for compensation costs and payments are raised according to which contribution groups gave rise to the compensation claim.

The contribution groups are:

- A1 – Accepting deposits
- A3 – General insurance
- A4 – Life insurance
- A7 – Fund managers
- A9 – Managers of AUTs, ACDs and depositories
- A10 – Dealing as principal
- A12 – Brokers holding client monies
- A13 – Brokers not holding client monies
- A14 – Corporate advisers
- IFA pensions review (formerly A16)
- A18 – Mortgage brokers
- A19 – Insurance brokers

There are limits to the protection FSCS can provide

1. Compensation limits:

- Deposit claims: up to £31,700. (100% of the first £2,000 and 90% of the next £33,000).
- Insurance contracts: 100% of the first £2,000 of a claim or policy, plus 90% of the remainder, with no upper limit. Compulsory insurance contracts (for example third party motor insurance) are protected in full. These limits also apply to business conducted on or after 14 January 2005 by insurance brokers.
- Investment claims: £48,000 (100% of the first £30,000 and 90% of the next £20,000).
- Mortgage advice and arranging (for business conducted on or after 31 October 2004): £48,000 (100% of the first £30,000 and 90% of the next £20,000).
- FSCS can pay compensation only for financial loss.

2. General limitations

- CLAIMS: Claims must be eligible under its rules, which are made by the Financial Services Authority (FSA). The rules tell FSCS which types of claim are eligible for compensation, and limit the amounts of compensation it is allowed to pay.
- DEFAULT DECLARATIONS: As a fund of last resort, under our rules FSCS can pay compensation only when an authorised firm is unable, or likely to be unable, to pay claims made against it. We describe this as being in default. FSCS will carry out an investigation to establish the financial position of the firm. If a firm (or its principals) is able to meet claims, those claims fall outside our jurisdiction, even if the firm has stopped trading.