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MEDIA INFORMATION

FSCS 2006/07 PLAN AND BUDGET

TOTAL LEVY FOR 2006/07 PROJECTED TO BE £75.4 MILLION (£138m in 05/06)

**BUT RISING ENDOWMENT CLAIMS MEAN IFAs (A13) FACE
LIKELY £47.5m LEVY (£37.8m IN 2005/06)**

The Financial Services Compensation Scheme (FSCS), the UK's financial fund of last resort, has today published its plan and budget for 2006/07. The plan and budget gives the Scheme's initial estimates of the levies it will need to make in the financial year 2006/07 and explains its strategies for handling significant increases in investment claims.

FSCS is predicting that its total initial levy will fall by £62.6m to £75.4m and that, overall, compensation payments in 2006/07 are likely to be in the region of £186.7m. The reduction in initial levies largely reflects recent large recoveries from the estates of insolvent general insurers and a short-term reduction in the funding requirement for claims in that sector. These figures do not include any amounts for potential splits claims that may need to be considered by FSCS during 2006/07.

FSCS is forecasting that the high volume of new endowment claims being received in the financial year 2005/06 (current forecast is 22,000) will continue into 2006/07. As a result it expects that the initial levy for group A13 (non client fund holding IFAs) will increase from £37.8m last year to £47.5m in 2006/07, an increase of 25%.

Loretta Minghella, chief executive of the FSCS, said:

"We forecast that we will need to complete around 29,000 investment claims in 2006/07, which is a 500% increase on the total number of investment claims completed in the full year 2004/05 (4,900), and is mainly driven by increases in endowment claims.

"Inevitably, the rise in the numbers of endowment claims we have to handle has a major impact on the levy for IFAs. We know this is tough news for the sector, and we have been working closely with trade bodies to help them understand the issues we are facing and to get their feedback on the strategies

we are adopting. Striking the right balance between the costs for levy payers and waiting times for consumers is, as ever, the key factor driving our approach.”

FSCS forecasts that the total cost of managing the Scheme (management expenses) in 2005/06 will be £22.4m. It expects this to rise to £29.4m in 2006/07. The increase in management expenditure is needed to enable FSCS to deal with the high volumes of claims currently being experienced and likely to be received.

Loretta Minghella continued:

“Higher claims volumes received in 2004/05 and again in 2005/06 have put a strain on our resources and some consumers have had to wait longer than we consider reasonable to get a decision on their claim. Our new claims handling strategy is helping to bring this under control. Our approach mixes increased outsourcing with small increases in internal recruitment and ensures that we can speed up processing times, whilst containing costs for the levy payer in the long term. At the same time, by using outsourcing we can cut back on these costs quickly and cost effectively as and when claims volumes decline.”

Key facts from the Plan and Budget:

1. **MELL & 2006/07 levies:** The FSA is consulting on a Management Expenses Levy Limit (MELL) of £37.06m, which includes a central budget of £29.37m for FSCS and a Reserve Contingency of £7.69m. The current initial forecast for overall levies in 2006/07 is £75.35m. The contribution group most affected by this initial forecast levy is A13 – investment advisers. Breakdowns for contribution groups are on page 6.
2. **The Reserve Contingency** allows FSCS the flexibility to increase resources if necessary to deal with claims above its central estimates, should these occur, and for areas of uncertainty, such as splits and claims against general insurance broking firms where claims types and volumes are currently too uncertain to include in its central budgets.
3. **Endowment claims** remain at high volumes. FSCS is currently forecasting 26,000 new claims in 2006/07, based on the mid-point of a range of its forecasts. FSCS expects to process around 63% more claims in 2006/07 (24,500) than it is forecasting for 2005/06 (15,000) and will be using a mix of internal recruitment and increasing its use of outsourcing to help it achieve this.
4. **Splits:** FSCS still anticipates that a significant number of claims relating to split capital investment trusts will need to be handled by the Scheme, but it is too early to predict volumes or likely values, or where the costs will fall. FSCS is liaising with the administrators of Exeter Fund Managers, who have been gathering information from customers of this firm to try to

determine the likely volumes and timing of any claims relating to this firm that could fall within the remit of FSCS.

5. **High street firms:** FSCS anticipates some new defaults of high street insurance brokers, but the number and value of claims is currently too uncertain to include in its 2006/07 levy calculations.
6. **Initial levy figures** are only early indications of FSCS's potential levy requirements. Actual 2006/07 levy requirements will be announced in April and will depend on updated information, including claims trends, uphold rates and average payments, at that time.
7. **FSCS announced its intention to refund a surplus of £42m** to relevant firms in the general insurance contribution group A3¹ before the end of the financial year 2005/06. This is a result of significant recoveries made from general insurance estates and lower than anticipated compensation payments in the sector. It has also announced that, based on current information, it is unlikely to need to raise a levy on this contribution group during 2006/07.

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Extracts from the Plan and Budget:

- **Claims figures and forecasts on pages 4 and 5.**
- **Levy breakdowns for contribution groups on page 6.**

Notes for Editors on page 7.

¹ Relevant firms are those in contribution group A3 that paid levies in 2005/06 to fund compensation payments relating to that group. For details of the funding structure for FSCS and contribution groups, see Notes for Editors on page 5.

Claims forecasts 2006/07

Based on our mid-range forecasts, we are planning to complete around 63% more endowment claims in 2006/07 than in 2005/06. Our updated forecasts for 2005/06 are on page 10. The overall number of investment claims in total forecast to be processed during 2006/07 has increased by over 500% compared to the financial year 2004/05.

² Other investments and mortgage intermediaries.

³ Figures relate to payments only. Insurance claims are usually handled by the appointed run-off agent and presented to FSCS for checking and payment.

⁴ This includes bonds that have not matured.

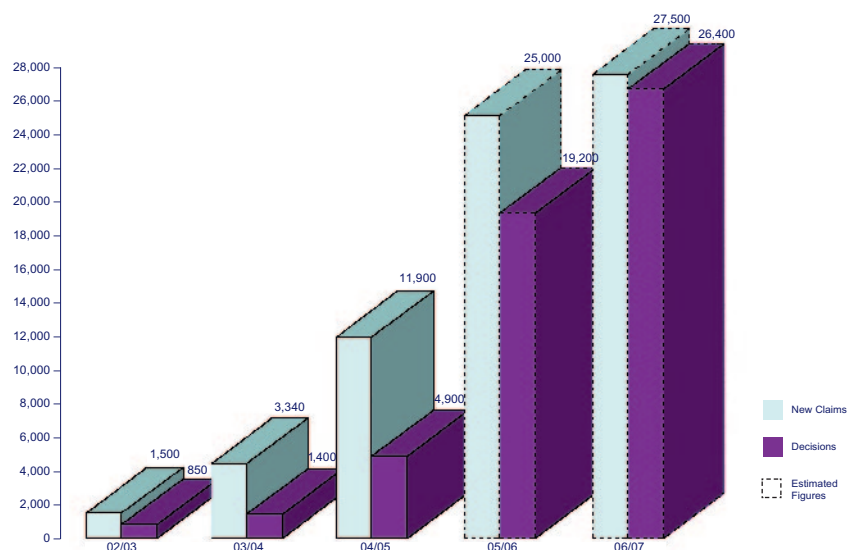
Table 1	Estimated claims in progress at 1.4.2006	NEW CLAIMS FORECAST: Lower forecast for 2006/07	NEW CLAIMS: MID-RANGE forecast for 2006/07	NEW CLAIMS FORECAST: Upper forecast for 2006/07	Forecast decisions in 2006/07	Forecast claims in progress at 31.3.2007
Investments:						
Endowments	15,700	20,000	26,000	32,000	24,500	17,200
Precipice bonds	500	50	100	150	300	300 ⁴
Investment & MI ²	450	1,200	1,400	1,650	1,600	250
Total investments	16,650	21,250	27,500	33,800	26,400	17,750
Pensions Review	1,700	250	350	450	2,000	50
Credit unions	90	200	300	400	350	40
TOTAL CLAIMS	18,440	21,700	28,150	34,650	28,750	17,840
Insurers ³	0	12,000	14,000	16,000	14,000	0

Claims trends

In the last few years, FSCS has been affected by significant increases in claims volumes, combined with changes in the types of claims received, particularly relating to investments. (See bar chart below).

Excludes Pensions Review and Free Standing Additional Voluntary Contributions Review claims

Investment new claims and decisions year-by-year



Increases in claims mainly related to endowments, although in 2004/05 around 2,500 claims related to precipice bonds.

Claims forecasts 2005/06

The 2005/06 forecast currently shows around 26,000 new claims coming in to the Scheme during the year. The majority of new claims are expected to relate to endowments, although we are still receiving a small number of precipice bond claims.

Table 3	Claims in progress at 1 April 2005	Estimate of new claims	Estimate of claims completed	Claims in progress at 31 March 2006
TYPE OF CLAIM				
Investments:				
Endowments	8,700	22,000	15,000	15,700
Precipice bonds	1,500	2,000	3,000	500
Others, excl. splits	650	1,000	1,200	450
Total investments	10,850	25,000	19,200	16,650
Pensions Review	5,000	1,100	4,400	1,700
Credit unions	40	250	200	90
TOTAL CLAIMS	15,890	26,350	23,800	18,440
M&GI firms ⁶	0	450	150	300
Insurance payments ⁷	0	43,000	43,000	0

⁶ Mortgage and general insurance intermediaries.

⁷ Figures relate to payments only. Insurance claims are usually handled by the appointed run-off agent and presented to FSCS for checking and payment.

Levy estimates

in the year ended 31 March 2007

Compensation costs, fund balances and levies

Estimated compensation payments in 2006/07 of £186.7m are based on forecast claims outputs, estimated uphold rates and forecast payment amounts based on the preceding 12 month rolling average. The current illustrative levy, due for collection in 2006/07, is £75.35m and reflects these estimates, forecast recoveries and management expenses (see tables 6 and 7).

THESE FIGURES ARE ILLUSTRATIVE ONLY AND MAY BE SUBJECT TO SIGNIFICANT CHANGE

Table 6 - Initial levy estimates by contribution group

Levies by contribution group	Group	2005/06 ⁸ Forecast levy	2006/07 INDICATIVE levy	Increase / (decrease)
		£m	£m	£m
Accepting deposits				
Deposit takers	A1	0.0	0.0	0
Insurance				
General insurance	A3	52.2	0.0	(52.2)
Life insurance	A4	0.0	0.0	0
Insurance intermediaries	A19	1.1	0.5	(0.6)
Investments				
Fund managers, holding client money/ assets	A7	0.2	0.3	0.1
Managers of AUTs, ACDs and depositories	A9	0.0	0.0	0
Dealers as principal	A10	0.0	0.2	0.2
Brokers holding client monies	A12	12.3	1.5	(10.8)
Brokers not holding client monies	A13	37.8	47.5	9.7
Corporate advisers	A14	0.1	0.1	0
Mortgage brokers	A18	0.4	0.3	(0.1)
Pensions review	(A16)	33.9	25.0	(8.9)
Totals		138.0 ⁹	75.4	(62.6)

⁸ Extracted from unaudited management accounts.

⁹ The 2005/06 levy was announced at £127.7m, but further cash amounts have been received as firm tariff amounts were updated.

The key assumptions made in preparing the levy estimates are:

- 1 Accepting Deposits Sub-scheme** - surplus funds are not being repaid. This assumption is based on the view that a distribution of less than £5.0m is not likely to be cost effective, and that during 2006/07, at current outflow levels, the A1 fund balance is close to that figure.
- 2 Insurance payments** - insolvency practitioner estimates for each estate. Recoveries can have a significant impact on funding and levy requirements. In 2006/07 a levy is not anticipated in this area.
- 3 M&GI intermediaries** - at this time no compensation costs or related levies are proposed as these are currently too uncertain. Some core management costs have been included.
- 4 Investments** - compensation cost estimates and the average compensation payment and uphold rates applied for mortgage endowment, precipice bond and other cases are: £2,300 and 39%; £8,200 and 88% and £12,000 and 42% respectively. These are based on our experiences during 2005/06. The A13 levy includes forecast costs of £2.4m rolled forward from 2005/06.
- 5 Pensions Review** - the 2006/07 levy estimate has been positioned to minimise the fund balance as far as possible, allowing for any over-runs, by 31 December 2006, with no future levies intended.

Notes to editors:

Funding and contribution groups

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 became operational on 1 December 2001, when FSMA came into force. It replaced previous compensation bodies, including the Deposit Protection Board, Investors Compensation Scheme and Policyholders Protection Board at that time.

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. Recoveries are reflected within the relevant contribution group when received and are included in forecasts when reasonably certain in terms of quantum and timing.