

PRESS NOTICE: IMMEDIATE RELEASE: 19 JANUARY 2006

Compensation refund in 2005/06 and no 2006/07 levy planned for general insurers, says FSCS

The Financial Services Compensation Scheme (FSCS) today 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 today that, based on current information, it is unlikely to need to raise a levy on this contribution group during 2006/07. This is due to a short-term reduction in the funding requirements for general insurance compensation claims during 2005/06 and into 2006/07.

Loretta Minghella, Chief Executive said:

“This is great news for insurance firms. In recent years, the general insurance sector has had to pay significant amounts for compensation payments relating to the defaults of insurers such as Independent, Chester Street, Drake and KWELM. Whilst our primary role is to pay valid compensation claims we work hard to secure recoveries wherever we can. The timing and actual amount of any recoveries is difficult to predict, and during 2005/06 we recovered significantly more in the insurance sector than we anticipated.

In the general insurance area our costs are largely dictated by the liabilities that emerge in relation to insolvent insurance estates and the timing of any recoveries made are dependent on the insolvency practitioners. We are experiencing a short-term reduction in funding requirements, which means we should have sufficient funds to pay general insurance compensation claims during 2006/07 and up to the next expected levy collection in the Summer of 2007. Although we currently estimate that a significant levy will be required to fund general insurance compensation claims in 2007/08, possibly over £100m, it was clear after discussions with the ABI that a refund now would be appropriate.”

FSCS is an active member of creditors committees in the estates of insolvent insurers that fall within the remit of the Policyholders Protection Act 1975 (PPA). Responsibility for providing funding for protected claims passed to FSCS from the Policyholders Protection Board on 1 December 2001 (a date known as N2) when the Financial Services and Markets Act 2000 (FSMA) came into force. Since N2, recoveries amounting to over £300m have been made from the estates of insolvent insurers. Recoveries are usually applied to offset levy requirements of the next levy year. Estimates for compensation requirements (and therefore levies) are based on calculations made by insolvency practitioners of the likely amount and value of claims to be paid in the relevant insurance estates in a levy period. FSCS has the discretion to refund surplus funds, for example when significant recoveries are received.

- FSCS has levied the sector £325m to fund compensation payments from 1.12.01 – 31.3.05.
- Compensation payments in relation to insolvent insurance estates since 1 December 2001 total just over £400m to 31.3.05.

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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 2.

NOTES to editors:

Recoveries

Recoveries are taken into account when the timing and value of the recovery is known, and used to offset funding requirements in the relevant contribution group.

A refund may be considered if FSCS believes that it has more funds to the credit of a contribution group than it believes will be required to meet compensation claims relating to that contribution group for the following 12 months. The refund of £42m will be made on a pro-rata basis by reference to the compensation cost element of levy receipts in 2005/06, to those firms in contribution group A3 that conduct relevant business and which paid a compensation costs levy in 2005/06. Around 300 general insurers will benefit from this refund.

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.

The contribution groups are:

- A1 – Accepting deposits
- A3 – General insurance
- A4 – Life insurance
- A7 – Fund managers
- A9 – Managers of AUTs, ACDs and depositories
- A10 – Dealers 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

2006/07 Plan and Budget

FSCS is publishing its Plan and Budget for 2006/07 on 1 February 2006. This publication will include its current estimates for potential levies for all contribution groups during the financial year 2006/07.