
Financial Services Compensation Scheme
# Plan and Budget
2019/20

# Contents

# Chair's Foreword

## This *Plan & Budget* inaugurates my first full year as Chair of FSCS. It's been an enjoyable and successful year, with fresh ambition, and I'd like to thank all the talented and dedicated people here who make this progress possible.

**Marshall Bailey**
Chairman

I'm fortunate to have had a long enough run-in to form some clear impressions and to lead the Board's work on our strategy for the 2020s. Given the clear risks of mounting claims and rising levies, we are acting with urgency to ensure a sound framework for providing stability where we can.

One very clear impression is that FSCS casts a much longer shadow than its work as a compensation scheme might at first suggest.

That reflects FSCS's impact on both consumers and on the industry, which pay for us through the levy.

For consumers we are an important guarantor of stability. That is perhaps most obvious when banks, building societies or credit unions get into difficulty. Consumers need the reassurance that their money will be safe – up to our limit of £85,000 – and will be returned promptly. FSCS has done a great job since the financial crisis of raising awareness of this protection to around 80% of adults. That substantially reduces the risk of a bank run.

But we also know, thanks to our own research, that FSCS protection of other products, though much less well-understood, can make a difference to consumers' choices. This is particularly true of retirement savings. Although only half of people know FSCS protection applies to pension products, those who are aware have a higher propensity to save. 29% of people would invest more if they knew that their pension fund was protected by FSCS. And on average, each person within this group would invest a further £1,493 each year. They also make different choices about investments to generate an income in retirement.

This impact underlines why the FSCS Board believes FSCS must work with the industry and with the regulators to raise awareness of our protection of the full range of products we protect. We also want to ensure that, when firms do fail, consumers understand that they can use FSCS at no cost, without recourse to expensive representatives.

Our shadow also extends across the industry itself in the shape of compensation costs, which have risen over recent years – meaning we've had to share them across a wider number of firms. We expect our levies for 2019/20 to total £516m.

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**£516m**

Although necessary, this is a lot to pay for the stability and confidence which our protection engenders. How much better if stability and confidence were also underpinned by lower rates of firm failure, with FSCS there as a last resort?

That insight informs the Board's view that FSCS, working with the industry and with the regulators, can contribute much more to the prevention of firm failures.

This is partly about better foresight. Like our sister organisation, the Financial Ombudsman Service, we can help identify risks to consumers before they become widespread. And it's partly about the systematic collection and mobilisation of the intelligence we gather through our work on compensation and recoveries about the directors and advisers involved in mis-selling.

We can help prevent unethical or incompetent players reinventing themselves and causing losses to further customers.

Rest assured that, under my chairmanship, FSCS will work vigorously in 2019/20 and subsequent years with our partners to make a reality of these themes of awareness and understanding, protection and prevention.

Another very clear impression of my first months as chair is that FSCS, together with its partners, is well-equipped to deliver on our Plan & Budget for 2019/20 and the strategy which it launches. This is largely due to the leadership of our CEO, Mark Neale, and his team. Mark's dedication to FSCS has been transformative, although he is sadly leaving us later this year.

After nearly a decade at the helm he leaves behind him a dynamic and agile organisation, committed to providing an outstanding service to its customers and outward-looking in its willingness to engage and to learn.

I'm hugely looking forward as Chair to continuing this and working with FSCS's people and stakeholders to meet the challenges ahead.

# Chief Executive's Overview

## This is the last FSCS *Plan & Budget* that I shall introduce as Chief Executive. It is also the first *Plan & Budget* carrying forward FSCS's strategy for the 2020s – Protecting the Future – with its four pillars of: *prepare*, *protect*, *promote* and *prevent*. And the first year in which the recent Funding Review changes, with their increased compensation limits and new funding classes, will take effect.

**Mark Neale**
Chief Executive

As you might expect, our plan for 2019/20 maintains continuity with my nine years as Chief Executive, while also responding to the new challenges we see in the decade ahead.

One important continuity – which I hope will be welcome to levy payers – is that the increase to our management expense budget remains broadly flat in real terms. In 2019/20 our proposed budget (including the unlevied reserve) will rise by £1.9m, or 2.4%, to £79.6m. This is despite our forecast that claims in that period will rise by around 20% compared to this year.

We are able to maintain this control on costs despite these volume pressures as a result of the efficiency gains we have made, or expect to make, from our investments in a new operating platform and from our new partnership with Capita, which we put in place during this year.

Continuity goes deeper, however, than year-on-year consistency of budgeting.

I have seen the two biggest priorities of my time as CEO as, first, to ensure that FSCS is able to respond to major failures or another crisis – *prepare* – and, second, to improve our service to customers – *protect*.

The *Plan & Budget* we are publishing today maintains our progress in both respects.

FSCS is already well-prepared if called on to support the resolution of a failing bank, building society or credit union by paying out depositors. We have had the capacity to achieve a seven-day pay-out since 2011.

That capacity rests heavily on the quality of information about their depositors which banks, building societies and credit unions must maintain in the shape of single customer view files. In the year ahead we shall continue to develop the service we provide to firms to enable the self-verification of these files.

We often lack, however, equivalent high-quality information when insurance companies and investment firms fail. That compromises our ability to provide

In 2019/20 our proposed budget will rise to

**£79.6m**

prompt protection as we and insolvency practitioners reconstruct records held by brokers and finance companies. In particular, it can hold up our preferred approach of applying compensation to the provision of new insurance cover – so securing continuity for consumers – rather than the repayment of premiums.

A priority in the year ahead will, therefore, be to work with the regulators and with the industry to bring about improvements in the quality of customer information.

We shall also be taking further steps to provide an outstanding service to our customers who seek our protection.

There is no doubt that the speed and efficiency of our service has improved. Over 90% of customers are using the online claims service which came on stream in 2016. Satisfaction with this service has improved from 64% to 80% over the last twelve months. We shall invest further in digital technology in 2019/20 in partnership with Capita to improve the real-time information to customers about the progress of their claims.

We recognise, however, that empathy and responsiveness are just as important as speed as we see a continuing rise in complex pensions claims against advisers and against SIPP providers. We expect such claims to be roughly 25% higher in 2019/20 than this year and to constitute around 40% of our total, non-insurance, workload.

Such claims often involve the loss of all or most of people's retirement savings. These customers need to feel that FSCS has engaged sympathetically with their circumstances and, whether or not the claim is upheld, has explained our decisions clearly and has enabled them to get their lives back on track and to move on.

We are confident that our new partnership with Capita, which is now bedding in, will enable outstanding service in all these respects by giving FSCS access to know-how and resources we do not possess.

As the Chair has explained in his introduction, our plans for next year also provide for FSCS to respond to new challenges.

We have always looked outwards and sought to engage with our levy payers and with the regulators in taking forward our mission.

That engagement will now be more important than ever as we seek to ensure that consumers are better informed about our protection – *promote* – and that FSCS provides the insight and intelligence needed to prevent future failures and so to reduce future compensation costs – *prevent*.

Of one thing I'm confident, FSCS will rise to these challenges as it has risen to all the challenges we have faced in my nine years as chief executive. That is very much down to the many extraordinary and committed colleagues who work here.

# Funding Review

## 2019/20 is the first year in which the recent Funding Review changes will take effect.

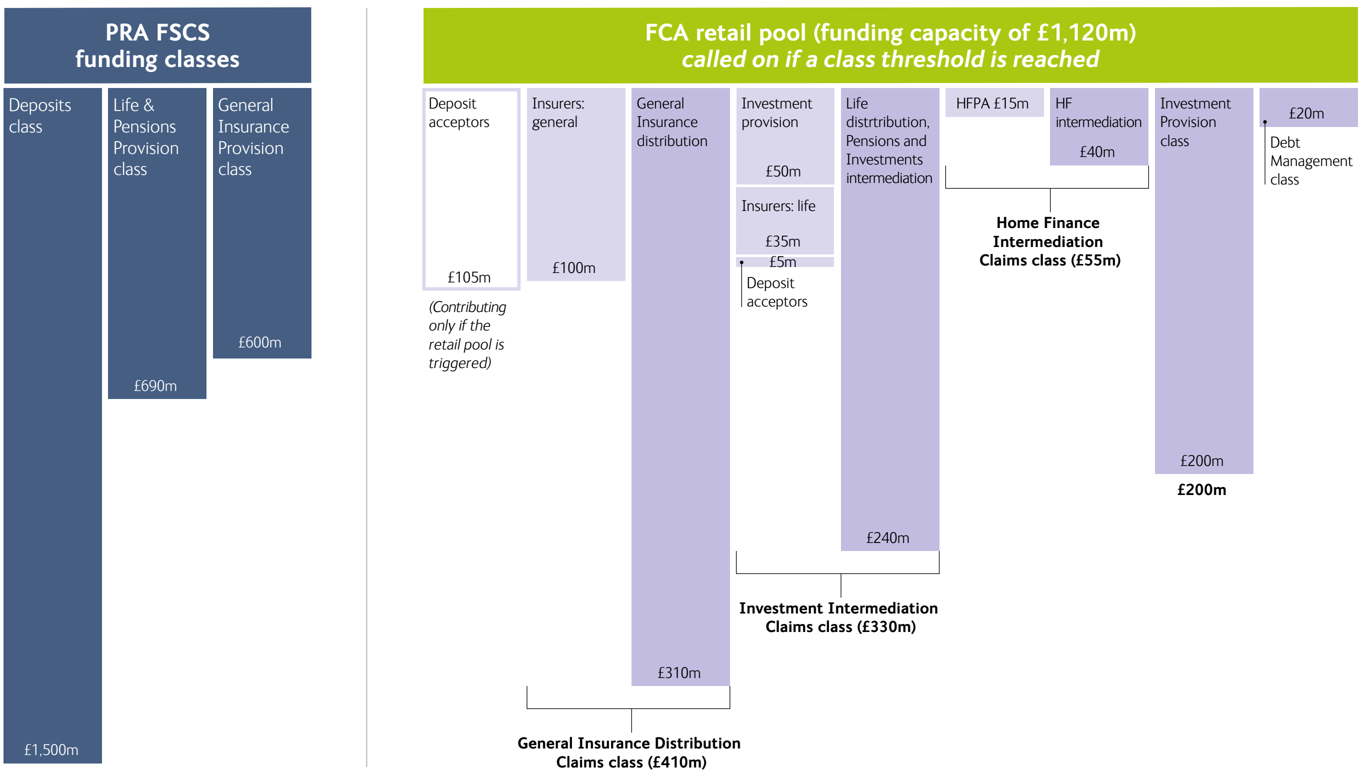
Not only will this mean changes to our funding classes but, more importantly for consumers, our compensation limits for several products will increase, as set out below. These new limits will only apply to claims relating to failures declared in default after 1 April 2019, rather than claims relating to failures declared in default prior to that date. We will be launching a communications campaign to explain these changes to consumers in the coming months.

### Figure 1 – Changing Compensation Limits

| Class | Current limit | New limit |
|---|---|---|
| Investment Provision | £50,000 | £85,000 |
| Investment Intermediation | £50,000 | £85,000 |
| Life & Pensions Intermediation | £50,000 | £85,000 |
| Home Finance Intermediation | £50,000 | £85,000 |
| Long term care insurance | £50,000 | 100% of the claim |

This will also be the first year of provider contributions which has an impact on the distribution of levies as detailed in the levy section.

### Figure 2 – The new classes



# Strategic Direction: FSCS into the 2020s

## We published our new strategy – 'FSCS into the 2020s - *Protecting the Future*' – in November 2018. This set out a vision for the organisation built around four strategic priorities of *prepare*, *protect*, *promote* and *prevent*:

- Prepare – FSCS must be able to protect consumers in a crisis or in the event of major failures to maintain public confidence and financial stability.
- Protect – FSCS is known and trusted for protection that puts people back on track through outstanding customer experience.
- Promote – The full range of FSCS protection is known about and trusted.
- Prevent – FSCS collaborates with our regulatory and industry stakeholders to help prevent future failures and to reduce compensation costs.

2019/20 will therefore be the first full year of this new strategy and so since its publication we have been planning the work required for each priority.

### Prepare

Our aim is to be ready to respond in the event of failures of all sizes and complexity and actively to contribute to increasingly effective resolution in the event of failures. When we published our strategy, we said we would do this by:

- maintaining well-tested contingency plans, backed by necessary capabilities
- collaborating with industry to improve the customer information we rely on for pay outs
- improving our ability to respond quickly to investment and insurance failures
- working with industry and regulators to improve resolution arrangements

These remain the key areas of focus, but we can be even clearer now about where our efforts will initially be targeted.

We will enhance our contingency plans by exploiting our strategic partnership with Capita, which gives us access to scale and technology. For example, we will look at how automation could further help us with processing of claims or how it could cut down the work involved in processing complex claims. This would free up our people to focus on the main value-adding activities of supporting our customers through the claims process and complex decision making.

Not only will we complete our contingency plan testing for the deposit sector, as required under the Deposit Guarantee Schemes Directive, but, working with the PRA, we will also develop and examine our plans to respond to the challenges of a life insurance failure. Of course, a key part of our preparedness is our ability to continue to provide our service to customers in the event of a disruption which affects FSCS. In this regard, we continue to enhance and validate our plans to deal with such disruptions, to provide continuity of service to our customers and regulatory partners.

We will improve the service to firms and the customer information we have in the deposits sector by evolving our self-verification platform. This empowers firms to review their own single customer view files, again freeing up our teams to add value by driving improvements in the quality of files more generally.

As Mark Neale highlights in his overview, the quality of customer data has hampered us in numerous failures in both the investment and insurance sectors over recent years. In some cases, we have had to wait before responding whilst working with failed firms and insolvency practitioners to piece together an accurate and complete set of customers impacted by a failure. We will therefore work with the industry on the customer information we require to improve our ability to respond quickly to failures of this kind.

We will also keep exploring possible new ways to pay our customers other than the Post Office Cash Over the Counter letters, cheques or direct bank transfers that we currently use. This will be especially important for customers of failed banks, building societies or credit unions. This is a fast-moving area, so we need to see when would be the best time to adopt any new approaches.

Finally, we have learned valuable lessons from the recent growth in complex and larger failures which we use to improve and test our contingency plans across our range of products. We will share these lessons with industry and regulators to enhance and entrench collaboration between all parties to seek improved responses and outcomes for customers, and all stakeholders.

## Protect

Our aim is to be known and trusted for protection that puts people back on track through outstanding customer experience. When we published our strategy, we said we would do this by:

- exploiting digital technology to create the service our customers expect, at lower cost to our levy payers
- improving the speed of our service by eliminating time and process inefficiencies, particularly with third parties
- exploiting our new strategic partnership – by drawing on our partner's expertise, scale and experience
- providing continuity of cover for policyholders in failed insurance companies

Our strategic partnership with Capita is key to this priority. This is currently being embedded and next year we intend to work together to improve our service by making sure it is efficient, easy to use, and takes care of our customers' needs. We will particularly focus on the support vulnerable customers require to make a claim in what can often be very difficult circumstances.

We have also established a programme to help us look long term at what 'outstanding experience' in the 2020s would mean for our customers. This will help us to deliver this experience and get a better view of the technology requirements that we will need in the coming years.

In the light of the transfer of regulation of Claims Management Companies (CMCs) to FCA and of the increase in the number of claims that come to us via CMCs, we will also reform our operating model to ensure that customers get as good a service whether they come to us directly or via a CMC, and that our dealings with CMCs are efficient for all parties.

We will continue to improve our communications when firms fail. By targeting customers who are actively seeking information about a particular firm, we can direct those impacted to our website where they can find more information about the status of the failure and whether they need to do anything to make a claim. This will help reassure customers and contribute to confidence in the financial services sector, as well as encourage claims to be made direct to FSCS.

## Promote

Our aim is to raise awareness of FSCS protection across all the products and services we protect, particularly retirement savings products. When we published our strategy, we said we would do this by:

- partnering with the industry to raise awareness of FSCS protection across all protected products and services, focusing on retirement savings initially
- engaging with consumers and providing information to help people understand protection and make informed decisions
- encouraging customers of failed firms to come directly to FSCS with their claim
- working with our stakeholders to provide joined up and easy to access information about FSCS protection

Work has started in all these key areas. In 2018/19 we began to test a new innovative Digital Marketing strategy focused on using new channels to increase the awareness of the full range of protection FSCS provides. We expect to have the outcomes of this testing completed soon so that we can roll out where we have been successful in building awareness of FSCS from the start of this year. Related to this we will continue to evolve all our digital channels to ensure that our messages are clear and relevant, focusing on the human stories behind the protection that we provide.

We will also extend the collaboration between FSCS and the industry that has worked well in the deposits sector, to increase awareness amongst consumers of the protection we offer on other products. Initially we will be focusing on the life and pensions sector, where research shows that awareness of our protection both increases propensity to save and the choice of investment. With our pensions working group, made up of industry representatives and other interested parties, we aim to finalise guidance to this sector on how to make use of FSCS's protected badge. We will continue our programme of research into the impact on consumers of awareness of FSCS protection to demonstrate the value to the industry of promoting our protection.

**Over 90%**
of customers are using the online claims service

Finally, we will explore additional opportunities to promote FSCS life and pensions protection in other areas such as including details of our protection on the new Pensions Dashboard and our badge on the simplified pension statements.

## Prevent

Our aim is to collaborate with the regulators and industry to prevent future failure and consumer detriment, and to reduce future compensation costs. When we published our strategy, we said we would do this by:

- committing to joint action with the regulators and industry to identify and address the root causes of mis-selling and other conduct issues which drive failure and compensation costs
- ensuring consumers are alerted more quickly to vulnerabilities and risks as they emerge
- working with our partners to improve co-ordination across government, industry and regulators, ensuring insights and intelligence are generated and acted on
- feeding back lessons learnt as a creditor and from recoveries activity, including working with the insolvency and insurance markets
- developing FSCS's own capability to provide actionable intelligence

These remain our areas of focus, and we have started work on several specific projects to support them.

We need to collaborate with our partners and stakeholders. As a start, we are reviewing the intelligence and data that we currently capture via our claims processes and will assess how best to use that information to support FSCS's strategy and the objectives of the regulators. Working with colleagues in industry and regulators we will also establish what additional information they would find useful that we could collect.

An early focus has been on the collection and sharing of intelligence and information that could help regulators tackle the issue of 'phoenixing'. We currently share information about firms, their principals and individual advisers who have been involved in failures but want to do so in a more systematic and effective manner. We are therefore exploring whether we can tie this information automatically to other external data sources we could draw on to provide the regulators with as complete a picture as possible of the activities of certain individuals.

We will also capture and share with greater rigour our experience and insight from our recoveries work. We believe a number of cases within this area could help establish systemic reasons for failures and claims that regulators could use to prevent these happening in the first place. We will also feedback on the effectiveness of PI Insurance – on which FCA made recent rule changes for investment firms.

Finally, working with the new Single Financial Guidance Body we will look to share lessons with consumers and provide direction to where they might find guidance and advice.

# Management Expenses

## The FSCS Board approved a management expenses budget of £74.6m.

This budget represents an increase of £1.9m (2.4%), compared to the 2018/19 budget. The PRA and FCA are consulting on the overall FSCS management expenses limit of £79.6m, which allows for an unlevied contingency reserve of £5m.

Figure 3 shows these costs via an activity-based view, comparative to 2018/19, and now includes an indication of which of our four strategic pillars the spending is associated with. As is fitting, given our statutory function, the Prepare and Protect pillars represent 93% of our costs whilst the Promote and Prevent pillars account for the remaining 7%. We are confident that this allocation of management expenses will enable us to deliver the ambitions established across all pillars as set out in our Strategy: *FSCS into the 2020s* and enable FSCS to deliver on its statutory responsibilities.

The key drivers to the overall 2.4% increase are:

- Outsourced claims handling – decrease of £2.6m:
  - Despite increasing SIPP and Pensions claim volumes (£3.9m in associated cost), effective price negotiations with our outsourcing partner are expected to yield £6.5m of reduced claims processing costs
- Internal claims handling support costs:
  - A reduction of £1.2m in Independent Insurance income as the insolvency estate's contribution has been exhausted, therefore our net cost base is increasing compared to 2018/19
- Core Support – a £2.6m increase:
  - We will invest in business-critical skills, including a small increase in headcount, strengthening FSCS operations and ensuring preparedness when responding to claims
  - This will include investment in payments, finance and sanctions processes
  - Investment in IT, in particular cyber security, to sustain our technology infrastructure and invest in greater security given the threat of cyber-attacks
  - And investment to support early work on our Prevent strategic pillar, in particular to contribute to how we better collect data and intelligence to share with the authorities
- Provisions for the UK's exit from the EU, uncrystallised failures and VAT (increase of £0.6m):
  - This includes a contingent provision for a range of eventualities, including uncrystallised firm failures, a potential VAT liability on insurance claims handling and the UK's exit from the EU

## Figure 3 – Management Expenses by Activity and Strategic Pillar

| Category | Strategic Pillar | 2018/19 Budget (£m) | 2019/20 Budget (£m) |
|---|---|---|---|
| **Claims handling infrastructure and support** | | **50.9** | **53.1** |
| Outsourced claims handling | Protect | 16.0 | 13.4 |
| Internal claims handling support | Protect | 7.6 | 9.5 |
| Core Support – IT, Facilities and central services | Protect/Promote/Prevent | 25.5 | 28.1 |
| Provisions for VAT, uncrystallised failures and UK's exit from the EU | Protect | 1.8 | 2.1 |
| **Bank Charges** | **Prepare** | **7.6** | **7.6** |
| **Deposit protection, recoveries, investment and pension deficit** | | **14.2** | **13.9** |
| Depositor protection | Prepare/Promote | 3.9 | 3.1 |
| Consumer protection | Prepare/Promote | 0.0 | 1.2 |
| Recoveries | Protect | 3.9 | 3.7 |
| Investment: digital and outsourcing | Protect/Prepare | 4.0 | 4.0 |
| Pension deficit funding | | 2.4 | 1.9 |
| **Total Management Expenses** | | **72.7** | **74.6** |
| **Unlevied Reserve** | | **5.0** | **5.0** |
| **Total including unlevied reserve** | | **77.7** | **79.6** |

## Figure 4 – Management Expenses by PRA/FCA split

| | FSCS Total costs (£m) | PRA fee block allocation (£m) | FCA fee block allocation (£m) |
|---|---|---|---|
| **Base Costs Total (Split 50:50)** | **27.0** | **13.5** | **13.5** |
| **Specific Cost** | | | |
| Deposits | 12.6 | 12.6 | |
| General Insurance Provision | 7.4 | 7.4 | |
| Life & Pension Provision | - | - | |
| General Insurance Distribution | 8.0 | | 8.0 |
| Life Distribution, Pensions and Investment Intermediation | 17.4 | | 17.4 |
| Investment Provision | 0.6 | | 0.6 |
| Home Finance Intermediation | 1.6 | | 1.6 |
| Debt Management | - | | - |
| **Specific Costs Total** | **47.6** | **20.0** | **27.6** |
| **Management Expenses Total** | **74.6** | **33.5** | **41.1** |

The prepare and protect pillars represent

**93%**

of our costs

# Claims assumptions – 2019/20

## FSCS has a pay-as-you-go funding approach. That is to say that we raise in our annual levies only the funds required to meet our forecast compensation cost and associated management expenses for this year.

To forecast the claims FSCS expects to receive over the next 12 months, we use data from a variety of sources such as the FCA, PRA, Financial Ombudsman Service and the industry as a whole. We also examine claims data and analyse trends, where there is sufficient information to quantify the numbers. Alternatively, we are able to levy for one third of the expected costs over the coming three years if there is a trend of rising claims. However, we do not make provision for particular firms which have not yet failed and so have not been declared in default. The assumptions we make and the trends we adopt are reviewed regularly, as they may change across the year, when for instance a large failure, or other unforeseen event, occurs. This helps us to determine the resources and expenses required to pay the claims we expect to receive.

2018/19 was an exceptional year with a 34% increase in actual claims compared to our original plan and budget (mainly driven by increased Deposits, Life & Pensions and Investment Intermediation claims, as covered below).

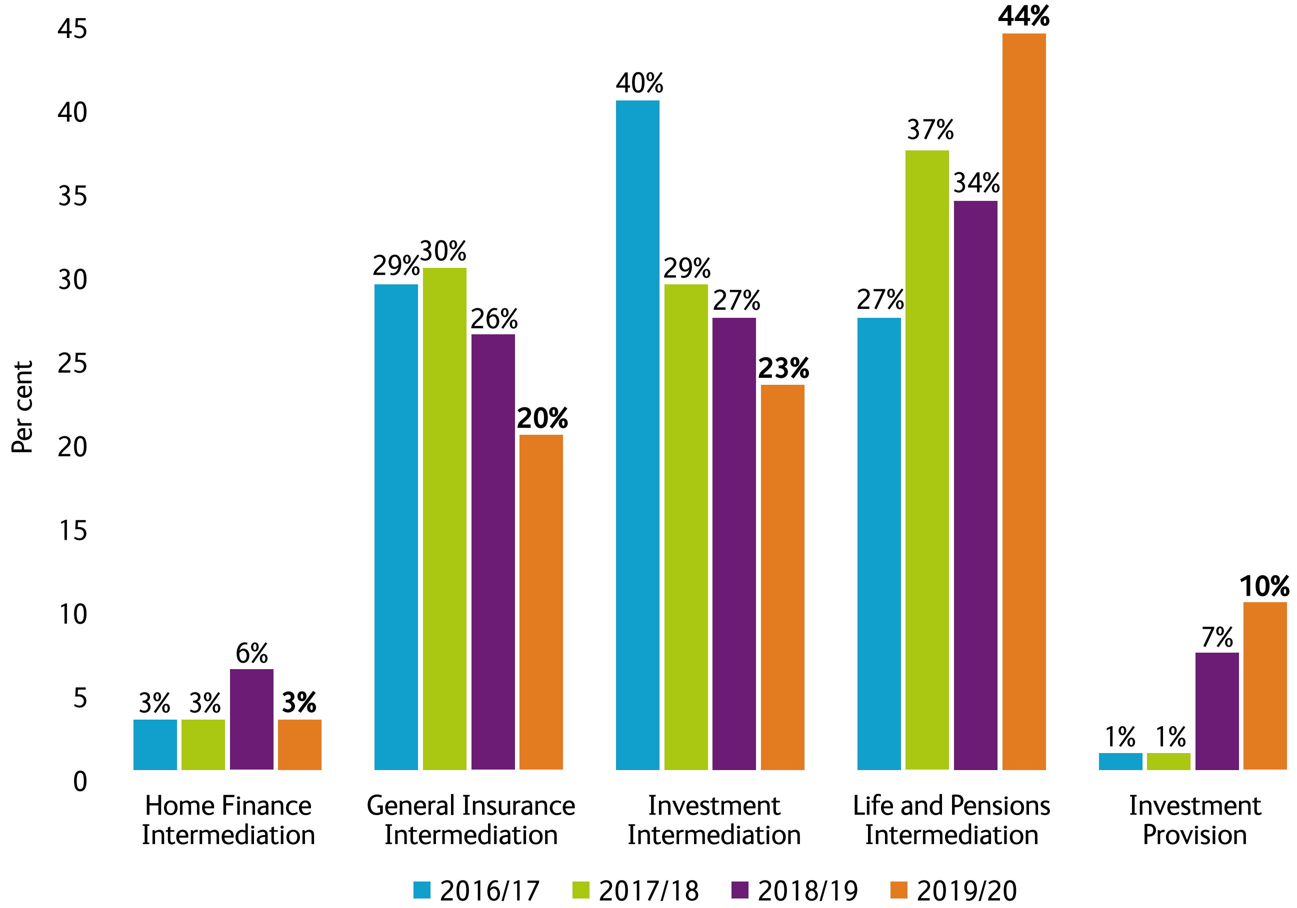
Against this high level we expect to see an overall drop of 12.5% in actual claim numbers in 2019/20 compared to 2018/19. This would however, still represent an 18%

### Figure 5 – Claims Assumptions 2018/19 and 2019/20

| | 2018/19 | 2018/19 | 2019/20 |
|---|---|---|---|
| **Claim Type** | **2018/19 Plan and Budget Assumption** | **Estimate of Completed Claims** *(% change from 2018/19 P&B)* | **2019/20 Plan and Budget Assumption** *(% change from 2018/19 P&B not completed estimate)* |
| Deposits | 6,000 | 10,693 (↑78%) | 7,680 (↑28%) |
| Home Finance Intermediation | 684 | 1,605 (↑135%) | 696 (↑2%) |
| Insurance Intermediation | 6,000 | 6,481 (↑8%) | 4,771 (↓20%) |
| Investment Provision | 1,500 | 1,665 (↑11%) | 2,399 (↑60%) |
| Investment Intermediation | 5,340 | 6,823 (↑28%) | 5,374 (↑1%) |
| Life & Pensions Intermediation | 7,200 | 8,623 (↑20%) | 10,482 (↑46%) |
| Debt Management | 0 | 0 (n/c) | 0 (n/c) |
| **Total claims exc insurance payments** | **26,724** | **35,890 (↑34%)** | **31,402 (↑18%)** |
| General Insurance Provision | 300,000 | 450,000 (↑50%) | 300,000 (n/c) |

Note: The Life and Pensions and Investment Intermediation classes will merge in 2019/20 to form the Life Distribution, Pensions and Investment Intermediation class

## Figure 6: Decision mix




increase against last year's plan and budget. Life and Pension claims (generally our most complex claim type), are set to continue with their high volumes and grow further, whilst PPI and Home Finance claims reduce.

The graph above highlights the changes in decision mix over recent years. General Insurance Intermediation (mainly PPI Claims) are among our most simple whereas Life and Pensions are among our most complex. Investment Intermediation claims in previous years have also included some high volumes of simple return of funds type claims, which can substantially alter the mix of claims we receive.

## Deposits

We allow for a small number of Credit Union failures each year, based on recent experience. To date, seven credit unions have failed in 2018/19 – a higher rate than usual. These included larger credit unions than normal, so increasing the number of protected depositors and the amount of compensation paid. We expect 2019/20 to return to the more usual volumes.

## General Insurance Provision

Activity in 2018/19 in terms of claim numbers was largely represented by 'Return of Premium' claims for Guaranteed Asset Protection (GAP) cover on both Enterprise Insurance, which failed in 2016, and Alpha, which failed in 2018. GAP insurance protects policyholders up to the purchase value of their car rather than the market value when a claim is made. In both cases compensation was used to pay for replacement cover for policyholders. Approximately 355,000 policyholders benefited from these arrangements. We expect to pay a further 30,000 'Return of Premium' claims on Alpha by April 2019. Residual claims consist of new claims on Legacy Estates such as Chester Street, Builders Accident and Independent.

The claims assumptions for 2019/20 reflect return of premium claims against the December 2018 default of the Danish Insurer Qudos, where we expect the majority of indemnity claims to be paid by the Danish Guarantee Fund. They also reflect Enterprise Insurance where we expect the Liquidator will cancel remaining policies and those will also be compensated by a Return of Premium. There will continue to be new claims from legacy estates, but we forecast that Alpha will not produce many new claims next year, unless the 'Return of Premium' claims noted earlier are deferred to 2019/20.

Horizon Insurance of Gibraltar also went into default in December 2018 and there are 1,700 motor indemnity claims where FSCS will be paying a contribution of 20% on each claim, with the remainder funded by the Horizon administration.

We expect the majority of compensation will be in respect of motor claims on Enterprise and Gable Insurance, as well as a significant value of payments in respect of mesothelioma triggered under employer's liability insurance policies issued by Chester Street, Builders Accident and Independent. These payments are likely to be on claims that have already been received rather than on forecasted new claims. We also continue to make payments on a small number of claims against firms that failed prior to 2016.

## General Insurance Intermediation

We have seen steady volumes of PPI claims during 2018/19 and expect this to continue through the early part of 2019/20 until the FCA cut-off date of 29 August 2019 for PPI complaints. Although the cut off does not apply to the claims FSCS receives, we expect there to be reduced claims coming from CMCs, who generate the majority of PPI claims received by FSCS, as they begin to move away from PPI. We forecast the tail of these claims to continue through 2019/20 at lower volumes than currently received.

Traditionally, PPI has been seen as one of the more straightforward claims to process, but even in this class, as new claims begin to reduce, we are seeing claims being made with more complex issues, including challenging customer circumstances or complicated histories, which are more difficult to process and take longer to obtain the relevant evidence required.

## Life and Pensions Intermediation

FSCS continues to receive significant numbers of claims against independent financial advisers regarding advice given to customers to transfer existing pension arrangements into SIPPs.

The vast majority of these claims relate to advice to invest pension monies into high-risk, non-standard asset classes within a SIPP wrapper. Because of the risky nature of these investments, many of the funds became illiquid and often insolvent. These investments are unsuitable for most investors and therefore the uphold rate is high.

Figure 7: General Insurance Intermediation Decisions and uphold rate

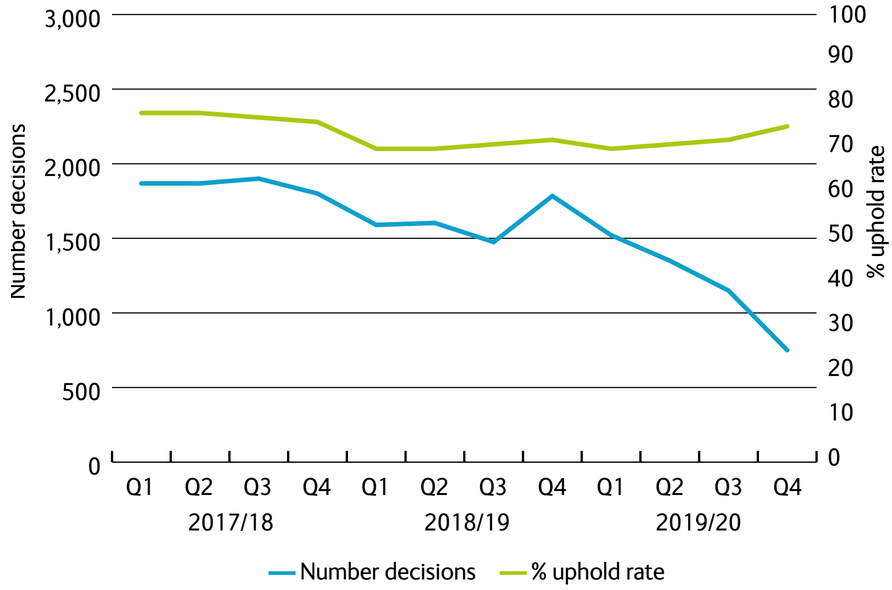
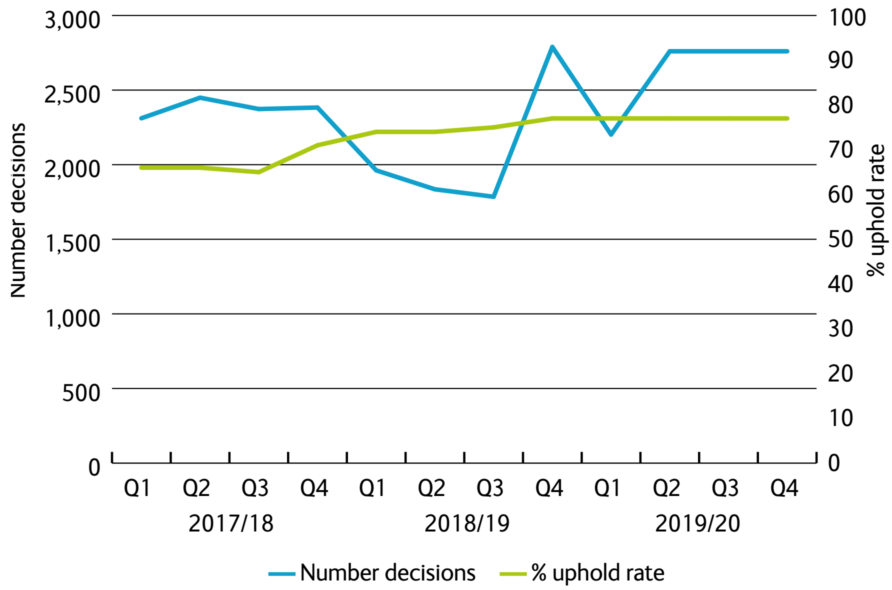



Figure 8: Life and Pensions Intermediation Decisions and uphold rate




FSCS expects to continue to see increased numbers of this type of claim, along with other life and pension related claims in 2019/20, following year-on-year trend increases, including increased CMC activity in this area, which invariably increases claim numbers. The continuing changes in this environment make forecasting future trends challenging.

Within this class, and these overall figures, we have also seen an increase in claims paid related to transfers away from defined benefit (DB) pension schemes, such as the high-profile case of the British Steel Pension Scheme. The proportion of claims paid in relation to unsuitable advice to transfer out of DB pension schemes has also increased slightly as a proportion of overall pension claims paid. This is largely due to a change in the methodology for calculating redress in these situations which involved a number of top-up payments, although it is also a trend we are expecting to continue.

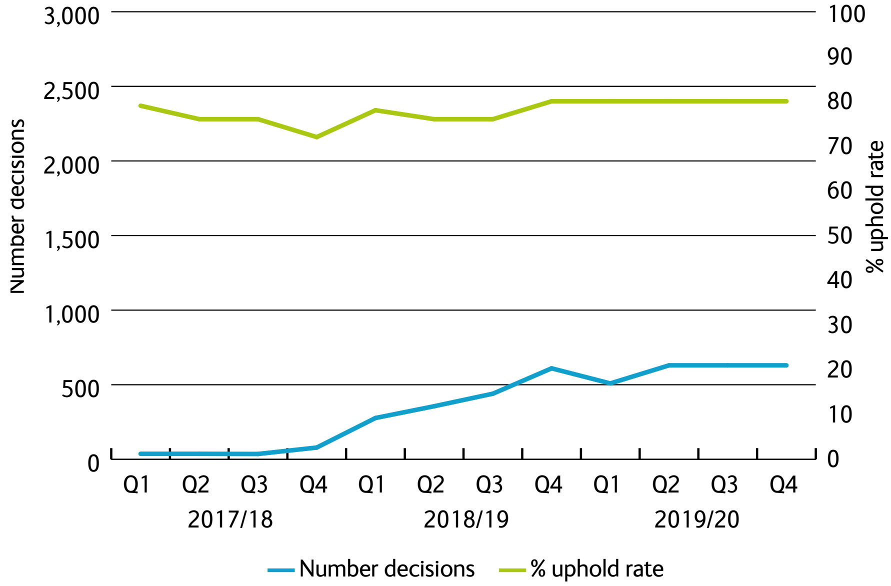
The levy forecast also factors in the increased compensation limit for this class which will commence from 1 April 2019 for claims relating to defaults declared after that date; this has also contributed to the increase in the levy forecast.

## Investment Provision

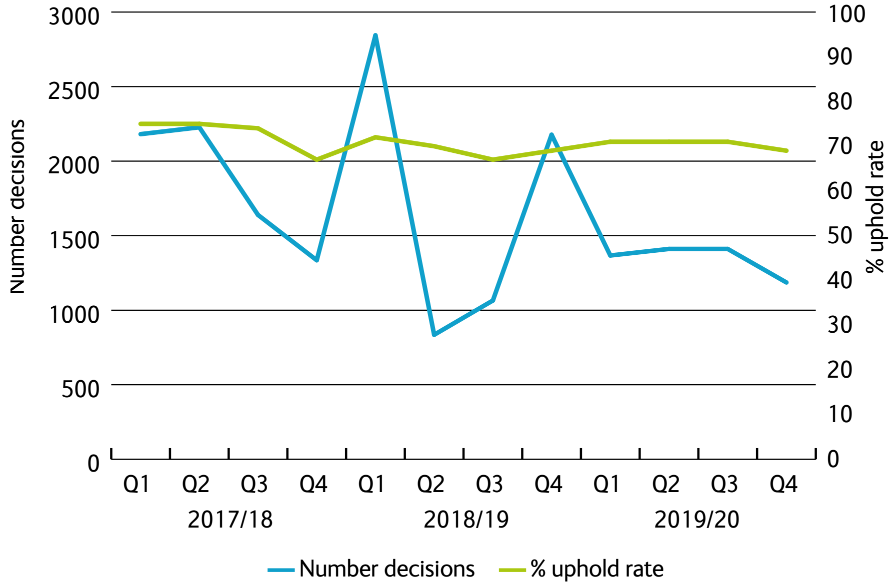
In January 2018 FSCS declared three SIPP operators (Stadia Trustees Limited, Brooklands Trustees Limited and Montpelier Pension Administration Limited) in default. The claims we have received against these firms are in relation to due diligence failings. These are the first such claims we have compensated on. The types of claims we receive are very complex, often requiring legal guidance and because of the level of funds invested in these pension policies, can be for losses in excess of our compensation limit.

The number of claims received has been higher than our original forecast, and with the potential for further defaults to be declared in 2019 the forecast for claims volumes continues to be high throughout 2019/20. CMC involvement in this area is growing which, as mentioned previously, correlates to increased claim numbers and with each new default in this class having potential for significant claims volumes, this makes this class challenging to forecast accurately for.

### Figure 9: Investment Provision Decisions and uphold rate




### Figure 10: Investment Intermediation Decisions and uphold rate



## Investment Intermediation

In recent years the volumes of these claims have been particularly difficult to forecast, mainly because of the number of product categories and firms in this class. However, FSCS continues to see sizeable volumes of investment claims against independent financial advisers in relation to negligent advice to invest in unsuitable funds and other types of investment. But the trends we are seeing suggest that these types of claims will start to reduce in 2019/20, in comparison to the actual volume of claims we have received in 2018/19.

Historically, FSCS has also had to respond to unexpected failures where firms have been placed into the Special Administration Regime (e.g. Alpari). Currently within our forecast are claims expected to be paid against Strand Capital, Beaufort Securities and other discretionary fund managers. These claims are twofold, one for client monies and assets held, and the other for mismanagement of the investments. This has driven increases in the levy forecast for this class. Many of these claims are

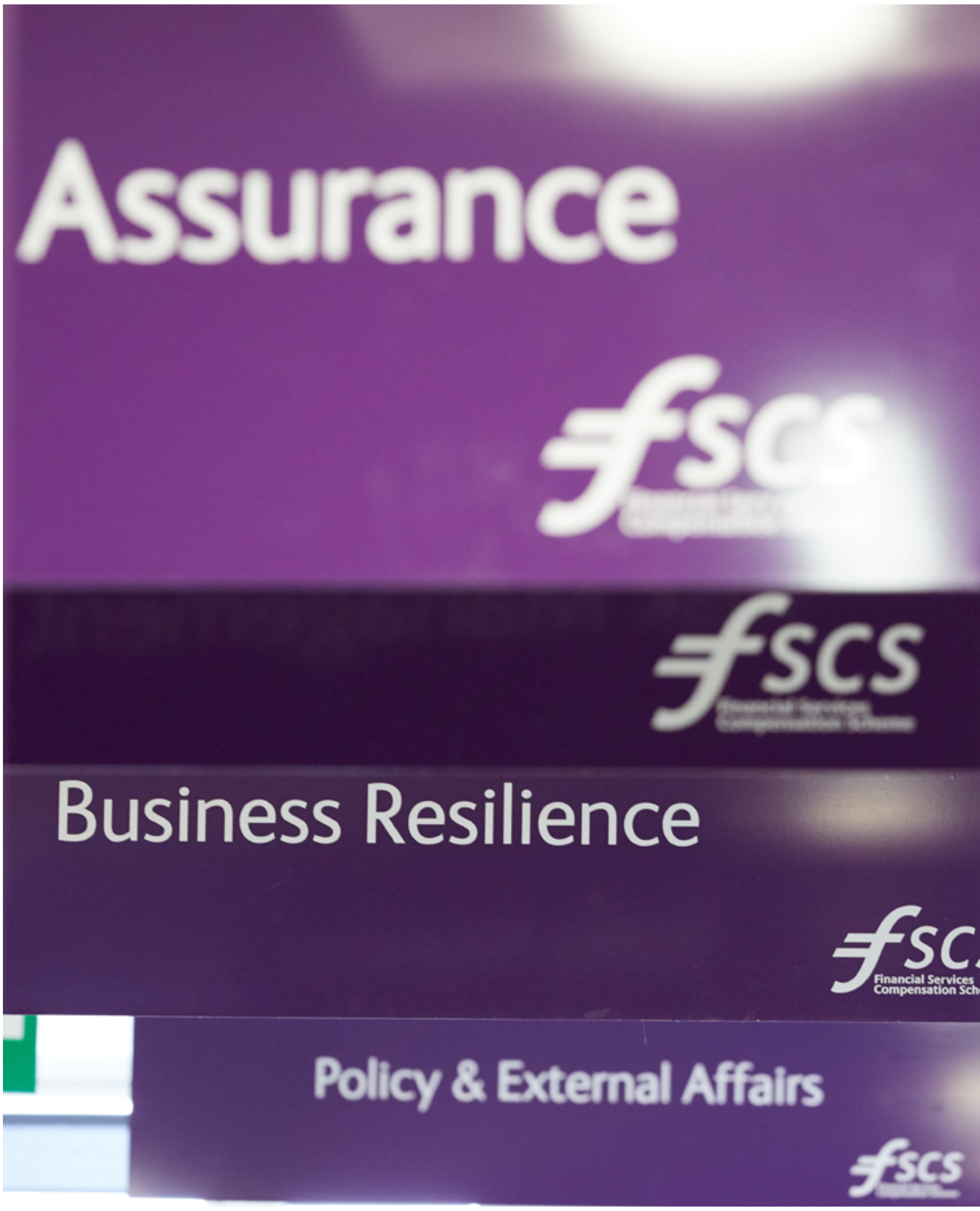
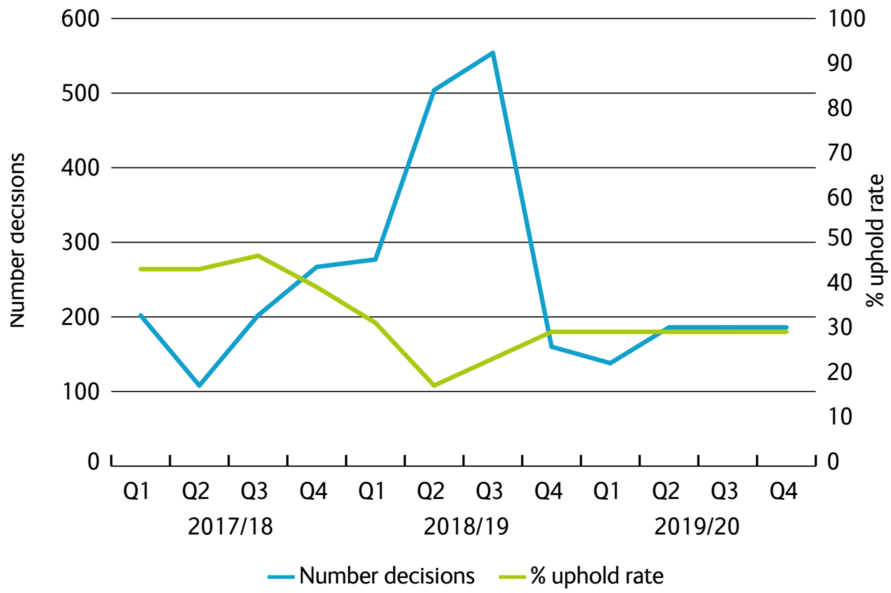


Figure 11: Home Finance Intermediation
Decisions and uphold rate




due to be processed in 2018/19, but if any further delays occur then these claims and associated costs will move across to 2019/20.

FSCS has elected to raise levies on a 36-month rolling average in recent years as we considered this the best way of making reasonable allowance for unforeseen failures, and this smoothed the impact of the levies on the class to good effect. However, following the consolidation of funding classes for intermediaries, we are applying a twelve-month forecast this time.

## Home Finance Intermediation

During 2018/19 we have seen a change in claims made to FSCS with increasing volumes of mis-selling claims being provided with very little substance or evidence to support the claim being made. Due to this, these claims have a low uphold rate, which is reflected in the graph above. We are making efforts to stop these claims before they are made and to make clear the evidence we would need to fully investigate the claims. This is factored into our forecast which sees the volumes and uphold rates return to their previous levels.

These changes have not impacted our levy forecast as we continue to receive consistent numbers of upheld claims.

## Debt management

From 1 April 2018 a funding class was created covering the business of debt management firms with a levy limit of £20m. We have yet to declare any firms in default in this class and we are not forecasting any for 2019/20.

# Compensation costs and levies

## 2019/20 Indicative Levy

Our forecast for indicative compensation costs and levies are based on a number of assumptions, the most important of which is our estimate of the volume and cost of claims we expect to receive during the year. We detail the assumptions behind these claims estimates in the next section.

The indicative 2019/20 levy amounts to £516m for a twelve-month period. This compares to £468m for the nine-month year of 2018/19.

The change from a nine- to a twelve-month period is the main reason for the increase in the levy from the previous year. If the 2018/19 levy had been for a twelve-month year, then it would have been £574m – £58m higher than the proposed 2019/20 levy.

As we indicated in our November edition of *Outlook* we have decided to raise supplementary levies in 2018/19. These affect the Life and Pensions Intermediation, Deposits, Investment Intermediation, General Insurance Provision, General Insurance Intermediation, and Debt Management classes. The main cause of these supplementary levies is a triggering of the retail pool caused by a £78m deficit in the Life and Pensions Intermediation class. The Dial-a-Cab and Alpha Insurance failures also contributed to additional supplementary levies in the Deposit and General Insurance Provision classes respectively.

Figure 12 - 2018/19 Final Levy compared with 2019/20 Indicative Levy by Class

| Funding Classes | 2018/19 Final Levy (£m) | 2018/19 Supplementary Levy (£m) | 2018/19 Total Levy (£m) | 2019/20 Indicative Levy (£m) | Variance (£m) |
|---|---|---|---|---|---|
| Deposits | 20 | 13 | 33 | **12** | (21) |
| General insurance Provision | 92 | 14 | 106 | **161** | 55 |
| General Insurance Distribution | 18 | - | 18 | **17** | (1) |
| Life Distribution, Pensions and Investment Intermediation | 119 | 78 | 197 | **240** | 43 |
| Investment Provision | 63 | - | 63 | **59** | (4) |
| Home Finance Intermediation | 22 | - | 22 | **5** | (17) |
| Debt Management | - | - | - | - | 0 |
| **Base costs** | **29** | **-** | **29** | **22** | **(7)** |
| **Total** | **363** | **105** | **468** | **516** | **48** |

Figure 13 – 2019/20 Net Amounts Payable by Class compared to 2018/19

| | 2018/19 Levy (9 months) | | | 2019/20 Levy | | | | |
|---|---|---|---|---|---|---|---|---|
| Funding Classes (To Fund) | Total Levies (£m) | Net Retail Pool (£m) | Total Payable (£m) | Indicative (£m) | Net Provider Contributions (£m) | Total Payable (£m) | Variance (£m) | Class Limit |
| Deposits | 33 | 9 | 42 | 12 | 4 | 16 | (26) | 1,500 |
| General Insurance Provision | 106 | 3 | 109 | 161 | 4 | 165 | 56 | 600 |
| Insurers: Life | | 6 | 6 | | 25 | 25 | 19 | 35 |
| Home Finance Providers & Arrangers (HFPA) | | 4 | 4 | | 1 | 1 | (3) | 15 |
| General Insurance Distribution | 18 | 24 | 42 | 17 | (4) | 13 | (29) | 310 |
| Life Distribution, Pensions and Investment Intermediaries | 197 | (67) | 130 | 240 | (65) | 175 | 45 | 240 |
| Investment Provision | 63 | 16 | 79 | 59 | 36 | 95 | 16 | 200 |
| Home Finance Intermediaries | 22 | 3 | 25 | 5 | (1) | 4 | (21) | 40 |
| Debt Management | | 2 | 2 | - | 0 | - | (2) | 20 |
| Base costs | 29 | | 29 | 22 | | 22 | (7) | n/a |
| **Total** | **468** | **0** | **468** | **516** | **0** | **516** | **38** | **n/a** |

Note: For Life Insurers the limit only applies to their provider contributions

## Provider Contributions

As previously stated, the 2019/20 levy will be the first to have the provider contributions. The intermediary classes will benefit from contributions from the related provider classes for all levies raised.

The net impact of these cross-subsidies showing the amounts that the classes will be required to fund are shown above, with a comparison with the previous year.

## Figure 14 – Forecast compensation costs by funding class

| Funding class | 3-yr average (£m) | 12-mth forecast (£m) | Notes |
|---|---|---|---|
| Deposits | n/a | 5 | Rules don't apply to deposits class |
| General Insurance Provision | 142 | 154 | Rising costs because of new failures, so three-year average not suitable |
| Life and Pension Provision | - | - | No claims expected |
| General Insurance Distribution | 13 | 9 | Declining trend as PPI claims reduce, so historical average not suitable |
| Life Distribution, Pensions & Investment Intermediation | 218 | 237 | Rising trend of claims in this sector. Historical average not sufficient |
| Investment Provision | 17 | 64 | History of low claims in this class so historical average not sufficient |
| Home Finance Intermediation | 15 | 10 | Expecting reduction in claims |
| Debt Management | - | - | No claims expected |

## Payment on Account

FSCS is able to raise levy payments on account for the 2019/20 levy year for those firms that already pay on account for their FCA and PRA fees. This population of around 1,000 firms represents the largest regulatory fee payers.

New rules allow FSCS to raise up to 50% of these firms' annual levies. This would allow us to collect £134m. We propose to do this.

Other firms will receive their invoices from the FCA over the summer as in previous years.

# Appendix: MELL view by standard expense lines

Figure 15: MELL view by standard expense lines

| | 2018/19 Budget (£m) | 2019/20 Budget (£m) |
|---|---|---|
| Staff Costs | 18.3 | 21.3 |
| Contractor Costs | 1.8 | 0.9 |
| Facilities | 3.1 | 3.2 |
| IT | 3.8 | 4.4 |
| Communications | 3.7 | 3.9 |
| Legal and Professional | 7.0 | 7.1 |
| External Providers | 1.6 | 1.5 |
| Depreciation | 0.4 | 0.4 |
| Other | 0.7 | 0.8 |
| Outsource claims | 14.0 | 13.1 |
| Outsource Printing | 0.7 | 0.3 |
| Change | 4.0 | 4.0 |
| Bank Charges | 7.6 | 7.6 |
| Provisions | 1.5 | 2.1 |
| Recoveries | 2.1 | 2.1 |
| Pension | 2.4 | 1.9 |
| **Management Expenses** | **72.7** | **74.6** |
| Unlevied Reserve | 5.0 | 5.0 |
| **Total Including Unlevied Reserve** | **77.7** | **79.6** |

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