Financial Services Compensation Scheme

Plan and Budget
2020/21

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Chair's Foreword
Marshall Bailey

This *Plan and Budget 2020/21* is led by our Strategy for the 2020s, which is now in its second year following its launch in November 2018. With so much anticipated change ahead of us this year, we will need to pay extra attention to the stability of the financial markets, and its impact on consumers. Our goal is to uphold our statutory duty in ensuring vulnerable customers are protected and that our protection is there when it matters. The staff of FSCS have made concerted efforts in laying solid foundations to support the Strategy's four pillars – Prepare, Protect, Promote, and Prevent.

It is particularly encouraging to know that FSCS's work under the Prevent pillar has been welcomed by members of the industry, understood by consumers, and praised by our partners in the anti-phoenixing work. The Insolvency Service has said that "Working collaboratively with our partners at FCA and FSCS means that not only are we more effective at sharing intelligence and co-ordinating activities to tackle phoenixing but together we are helping to thwart financial misconduct and prevent further abuse of the corporate and insolvency regimes." Using data analytics, computing advances and early warning processes to identify, predict and highlight trends and instances of phoenixing will be a particular focus of work in 2020.

As well as phoenixing, another major challenge for our financial services industry, which particularly involves FSCS, is the continuing rise of complex pension claims. These claims have, in recent years, overtaken Payment Protection Insurance (PPI) in terms of volume: now 40% of claims relate to pensions and 20% to PPI. The main causes are advice - and often mis-advice - to transfer out of defined benefit pensions, and the wrapping of risky and illiquid investments into Self-Invested Personal Pensions (SIPPs).

FSCS is acutely aware of the impact that this trend has on the size of the levy which we must raise on authorised firms to meet claims. Our perspective must be forward-looking, as befits the start of a new decade. The work done by FSCS is an integral part of the financial services industry, the regulatory family and consumer landscape. In our continuing dialogue as partners with those stakeholders on those issues, we will seek to help break the cycle.

While we are presently performing our duties well, the evidence of near-term future challenges in advice and suitability is cause for concern. We are motivated to work closely with our regulatory partners and with the wider financial services industry to reduce this as quickly as possible.

Looking ahead, FSCS supports the regulatory family's continued coordination efforts which manages the shared regulatory agenda. As FSCS Chair, I have been meeting with my counterparts to improve our strategic delivery and to share FSCS's data and insights. This is already progressing at a variety of working levels. FSCS hopes to gain further industry support to ensure we are achieving the best consumer outcomes, whilst mindful of costs to levy payers. We believe that it is in the levy payers' interest to help move this complex structure into a place where vulnerable people are not harmed.

On behalf of the Board, I'd like to extend our welcome and thanks to our new CEO, Caroline Rainbird, who shares our determination to drive our strategy and contribute towards financial stability. Her leadership, technical skill and passion will continue to move us quickly forward.

Chief Executive's Overview
Caroline Rainbird

I am delighted to introduce my first *Plan and Budget* as FSCS Chief Executive. The past eight months since joining FSCS, have left me very impressed by the strength of FSCS as an efficient and effective compensation scheme, delivering an empathetic service for consumers, many of whom are vulnerable. We are able to do this by working in partnership with the financial services industry and the regulatory family.

We are confident that this *Plan and Budget 2020/21* provides FSCS with the means to build on our strengths and meet the challenges the financial services industry and consumers will face throughout the coming year. It sets out progress that has been made on our Strategy for the 2020s based on the four pillars of Prepare, Protect, Promote and Prevent. It also addresses some key challenges FSCS will face including: continuing vulnerability of customers, rising customer expectations, a higher number of firm failures and a growing number of complex claims, an increased choice of financial products, a faster pace of technology change and an ever critical need to keep personal data secure. We are seeing many of these challenges starting to really impact upon our customers as well as levy payers.

Strategy for the 2020s Update

Prepare:
This pillar has delivered a number of improvements driven by engagement across FSCS and our partnership with Capita. For example, following the recent failure of one credit union, we issued compensation to customers on the same day the firm failed. Other improvements are being delivered through regular exercising for deposit and life insurance failures, data centre backup plans and crisis scenarios. Our ongoing programme of testing and exercising ensures that we are more prepared than ever to serve our customers when they need us most.

Protect:
The increased operational capacity and capability of recent months is now delivering consistent performance, resulting in improved customer outcomes. We continue to work with our partner Capita to embed a continuous improvement culture that drives productivity and quality resulting in, amongst other measures, enhanced operational efficiency. Our Service Design programme has started delivering great benefits to our customers which has positively impacted upon customer satisfaction and quality measures.

Promote:
We have seen a strong increase in prompted awareness of FSCS from 29% to 33% and broader awareness of FSCS or deposit protection remaining high at 79%. We are continuing to be proactive by treating each failed firm as a customer campaign, as well as thinking about the types of customers we might encounter and what their specific needs may be. Working with industry we have developed guidelines for the life and pensions sector to adopt the FSCS badge and supported mystery shopping across the industry, improving awareness and understanding of FSCS. We have carried out a proactive engagement campaign with MPs and journalists following our Treasury Select Committee appearance in July 2019 and are now targeting the new cohort of MPs.

Prevent:

The Prevent pillar has made good progress since April 2019 and we have worked with our regulatory partners to establish new ways of working. This is seen most prominently with our anti-phoenixing work – where the Financial Conduct Authority, the Financial Ombudsman Service, the Insolvency Service and FSCS are coordinating efforts to prevent future harm to consumers and the industry as a whole. Since September 2019, our claim handlers have picked up 19 potential cases of phoenixing which have been shared with the Financial Conduct Authority. A further 117 separate cases have been identified, leading to them being referred to the Financial Conduct Authority. Additionally, with FSCS's assistance, seven firms withdrew their applications once the Financial Conduct Authority discussed concerns over phoenixing with them.

London Capital & Finance (LCF):

On 9th January 2020, following a thorough factual and legal analysis, we announced that FSCS will pay compensation to some LCF investors and will start to review advice claims in the first quarter of 2020. At this stage it is too early to predict the full impact on the levy.

Management expenses:

The budget of £78.2m for 2020/21 represents a 1.3% increase on the latest full year forecast for 2019/20 of £77.2m. There is a £2.1m increase in costs not directly impacted by changes in claims volumes, driven by continued investment in business-critical skills and increased recovery costs, which is offset by a decrease of £1.1m in internal claims processing costs.

The budget for 2019/20 was based on processing 23,400 claims but we are forecasting to process 27,200 through to the end of 2019/20. Our expectation is that approximately the same level of claims will be received in 2020/21.

Levy – indicative 2020/21

The proposed 2020/21 indicative levy is £635m, an increase of £87m from the levies raised in 2019/20. The amounts that each class will pay i.e. including all provider and retail pool contributions are shown on p.10.

The overall increase is due to increasing SIPP operator claims, which continues the rising trend of pension-related cases, and the investment provider class is forecast to reach its annual limit, which will trigger the retail pool for these costs. We will keep this under review and provide an update during the year.

In summary the financial sector faces many changes and challenges as we enter the third decade of the 21st century. Claims are forecast to continue to rise, and we are already experiencing higher claims costs due to the complexity of cases being submitted, which in turn will have a direct impact on the levy for the coming year. We recognise the importance of remaining focused, well-resourced and prepared for these challenges, as well as continuing to deliver an efficient, effective and empathetic service. We are confident our *Plan and Budget 2020/21* provides us with the resources and strength to meet these demands in the interests of all our stakeholders.

Management Expenses

2020/21 is the second year of the Strategy for the 2020s and its delivery is one of the key drivers of the management expenses budget of £78.2m. This budget represents an increase of 1.3% on the latest full year forecast for 2019/20 of £77.2m and an increase of £3.6m (4.8%) compared to the 2019/20 budget.

The Prudential Regulation Authority and the Financial Conduct Authority will be consulting on the overall FSCS management expenses limit of £83.2m, which allows for an unlevied contingency reserve of £5m.

Figure 1 shows these costs via an activity-based view compared to the 2019/20 forecast. To provide clarity for the industry and to minimise the risk of utilising the unlevied reserve in 2020/21 the budget drivers have been split into:

- **Controllable costs** – defined as costs which are not directly impacted by changes in claims volumes (e.g. rent, rates, core support).
- **Volume-driven costs –** are directly impacted by changes in claims volumes (e.g. outsourced claims handling costs, internal claims handling resource, legal claims costs). The volumes and complexity of claims received has been subject to significant change over the last three years, almost doubling in that time. These trends are expected to continue.

The key drivers of the 1.3% increase are:

Recoveries – a £0.7m increase

- The recoveries spend in 2020/21 is expected to be higher than in 2019/20 as some costs have been deferred into next year.

Core support – a £0.7m increase

- Continued investment in business-critical skills in the digital and legal space, coupled with a 2% inflationary pay increase.

Figure 1: Management Expenses by activity and strategic pillar

ABC Category	Strategy Pillar	2019/20 Forecast (6 + 6)			2020/21 Budget		
		(£m)	Control-lable costs	Volume driven	(£m)	Control-lable costs	Volume driven
Outsourced claims handling	Protect	17.3	-	17.3	17.3	-	17.3
Core - claims processing - internal	Protect/ Prepare	11.7	5.4	6.3	10.6	5.3	5.2
Core support	Protect/ Promote	29.3	29.3	-	30.0	30.0	-
Deposit readiness	Prepare	6.8	6.8	-	7.2	7.2	-
Consumer protection	Promote	0.7	0.7	-	0.8	0.8	-
Depositor protection	Promote/ Prepare	2.8	2.8	-	3.0	3.0	-
Recoveries	Protect	2.7	2.7	-	3.4	3.4	-
Investment/Change	Protect/ Promote/ Prevent	4.0	4.0	-	4.0	4.0	-
Pension deficit funding	Protect	1.9	1.9	-	1.9	1.9	-
Total		**77.2**	**53.6**	**23.6**	**78.2**	**55.7**	**22.5**
Unlevied reserve		***Note**	***Note**	***Note**	**5.0**	**-**	**5.0**
Total including unlevied reserve		**77.2**	**53.6**	**23.6**	**83.2**	**55.7**	**27.5**

*Note: The forecast of £77.2m includes the utilisation of up to £2.6m of unlevied reserve within the outsourced claims line.

Compensation Costs and Levy

2020/21 Indicative Levy

Our forecast for indicative compensation costs and levy 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. These are uncertain and will be kept under review. We will be finalising the levy in the April *Outlook*.

The proposed 2020/21 indicative levy is £635m, an increase of £87m from the levy raised in 2019/20. The amounts that each class will pay i.e., including all provider and retail pool contributions, are shown in Figure 2. The levy is based on our forecast for the next 12 months' compensation costs (as shown in Appendix A).

There are three main reasons for the increase:

1) the total compensation cost has increased by £46m – mainly due to increasing SIPP operator claims falling on the Investment Provision class;

2) the 2019/20 levy benefited from an opening surplus of £32m, which is not available for 2020/21; and

3) the recoveries expected to be received in 2019/20 are £39m greater than forecasted for 2020/21.

The indicative levy is based on the brought-forward balance for each class as set out in *Outlook* published on 17th December 2019. Also, we can confirm that the supplementary levy for 2019/20 will be £50m for the Life Distribution, Pension and Investment Intermediation class, and £30m as a refund for the Deposits class.

SIPP operators

Claims in relation to SIPP operators are the biggest growth area and the reason for the increase in overall levy. These are claims where the conduct of the SIPP operators FSCS has declared in default gives rise to a civil liability to the investors because the SIPP operators failed to exercise reasonable care and skill, breached regulatory requirements and/or breached trustee duties. There have now been nine SIPP operator failures since January 2018 and the expected annual cost for 2020/21 is £209m. Prior to 2018 there had been no such failures. GPC SIPP Ltd and Berkeley Burke SIPP Administration Ltd have entered administration recently and there is a chance of more claims in this area. We now expect to make 7,700 decisions on these claims in 2020/21 which is a 114% increase on 2019/20.

Payment on account

To ensure FSCS has sufficient funds to meet its costs until the annual levy is collected in the summer, we intend to raise payments on account as we did in 2019/20. We expect to collect approximately £210m from the top 1,000 regulatory fee payers in March and April 2020, which will be offset against their annual levy invoices issued in the summer.

Figure 2: 2019/20 Final levy including all provider and retail pool contributions compared with 2020/21 indicative levy by class

Classes	2019/20 Levies			2020/21 Budget				
	Levy raised (£m)	Supple-mentary levy (£m)	Total (£m)	Levy for costs of class (£m)	Provider contri-butions *(£m)	Retail pool *(£m)	Indica-tive levy (£m)	Move-ment (£m)
PRA Classes								
Deposits	19.0	(29.0)	**(10.0)**	13.0	4.0	4.0	**21.0**	31.0
Life and Pension Provision	22.0	5.0	**28.0**	-	30.0	1.0	**31.0**	3.0
General Insurance Provision	165.0	-	**165.0**	111.0	4.0	3.0	**118.0**	(47.0)
FCA Classes								
General Insurance Distribution	12.0	-	**12.0**	17.0	(4.0)	10.0	**23.0**	11.0
Life Distribution, Pensions and Investment Intermediation	153.0	36.0	**189.0**	239.0	(34.0)	8.0	**213.0**	24.0
Home Finance Providers	1.0	-	**1.0**	-	1.0	-	**1.0**	(0.0)
Home Finance Intermediaries	4.0	-	**4.0**	3.0	(1.0)	1.0	**3.0**	(1.0)
Investment Provision	132.0	8.0	**139.0**	228.0	-	(28.0)	**200.0**	61.0
Debt Management	-	-	**-**	-	-	1.0	**1.0**	1.0
Base costs	21.0	-	**21.0**	24.0	-	-	**24.0**	3.0
Budget total	**528.0**	**20.0**	**548.0**	**635.0**	***0.0**	***0.0**	**635.0**	**87.0**

*Note: Both the provider contributions and the retail pool columns show the levies to be raised for costs of other classes. A positive number shows the contribution to other classes and a negative is where the class is receiving levies from other classes.

Claims Assumptions – 2020/21

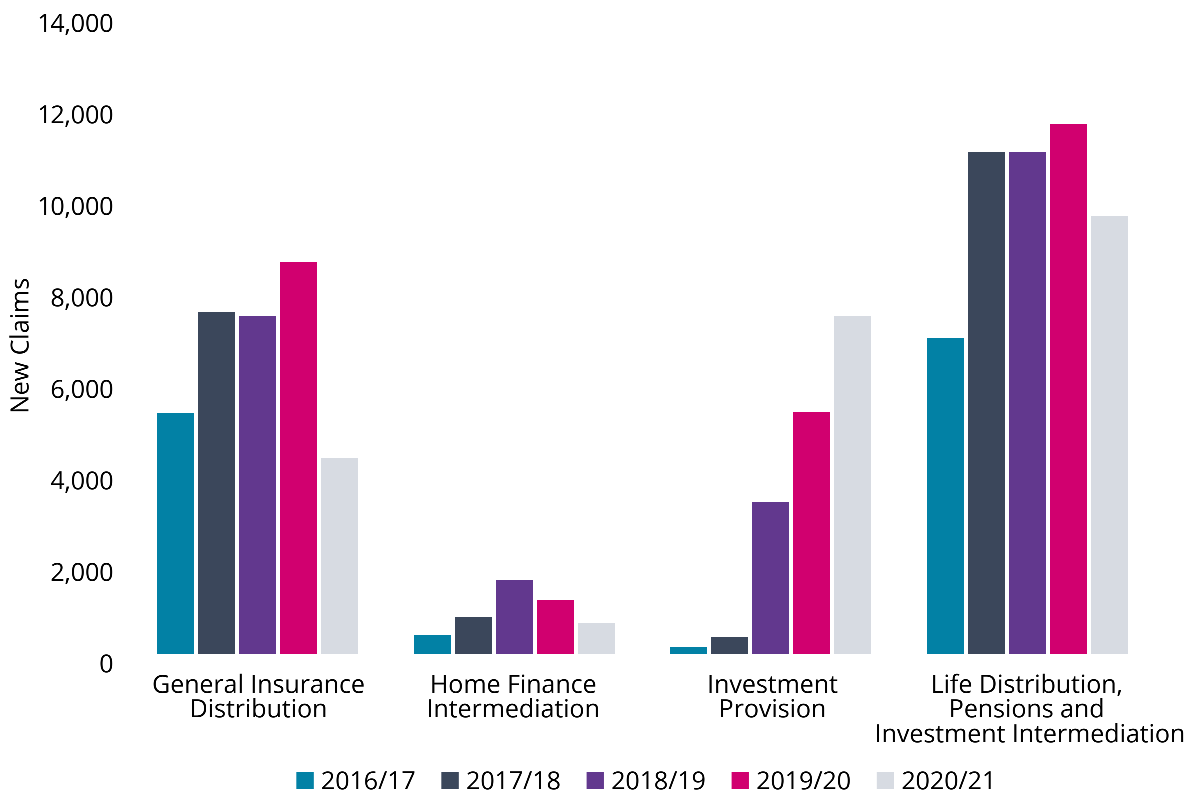
FSCS forecasts claims volumes by utilising data from a variety of sources such as the Financial Conduct Authority, Financial Ombudsman Service, Prudential Regulation Authority and the industry as a whole.

The assumptions and trends made in this forecast are reviewed monthly and as such may change across the year, when for instance a large failure or unforeseen events occur. The numbers will be revised before the final levy is set in April 2020.

Figure 3: Claims assumptions 2019/20 and 2020/21

	Estimate of Completed Claims		
Claim type	**2019/20 Original forecast**	**2019/20 Revised Forecast** *(% change from 2019/20 Original Forecast)*	**2020/21 Plan and Budget assumption** *(% change from 2019/20 P&B not completed estimate)*
Deposits	7,680	10,847 (↑41%)	7,680 (↑0%)
Home Finance Intermediation	865	1,183 (↑37%)	744 (↓11%)
General Insurance Distribution	5,713	8,262 (↑44%)	4,775 (↓17%)
Investment Provision	4,640	6,062 (↑31%)	8,202 (↑77%)
Life Distribution, Pensions and Investment Intermediation	14,162	14,474 (↑2%)	10,134 (↓28%)
Debt Management	-	- (n/c)	- (n/c)
Total claims excluding insurance payments	**33,060**	**40,828 (↑23%)**	**31,535 (↓5%)**

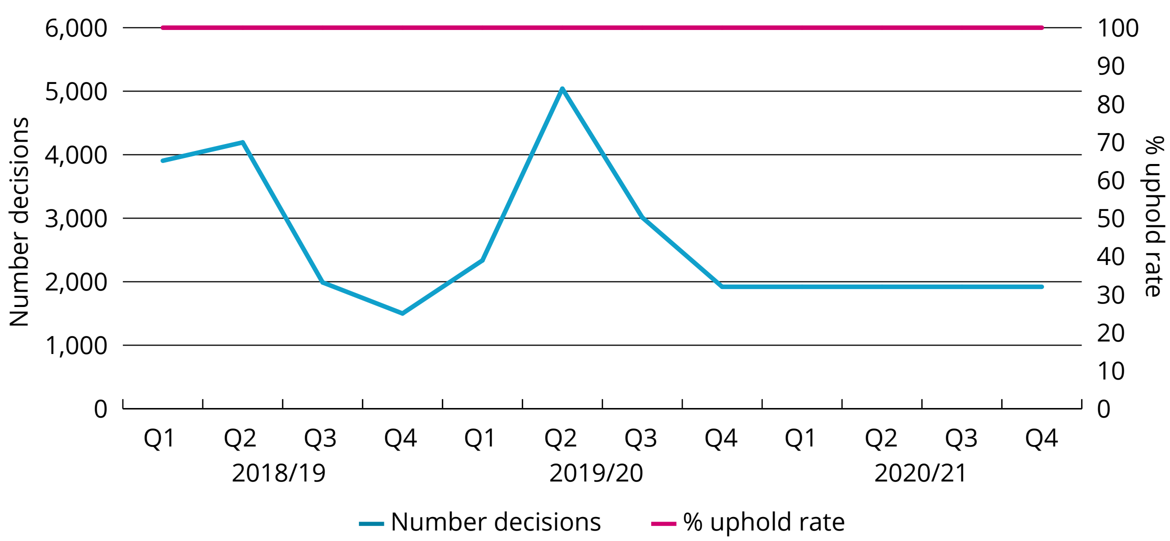
Figure 4: FCA Funding class summary



Deposits

This year we have had seven firm failures within the class. We are allowing for a similar number next year.

Figure 5: Deposits decisions and uphold rate

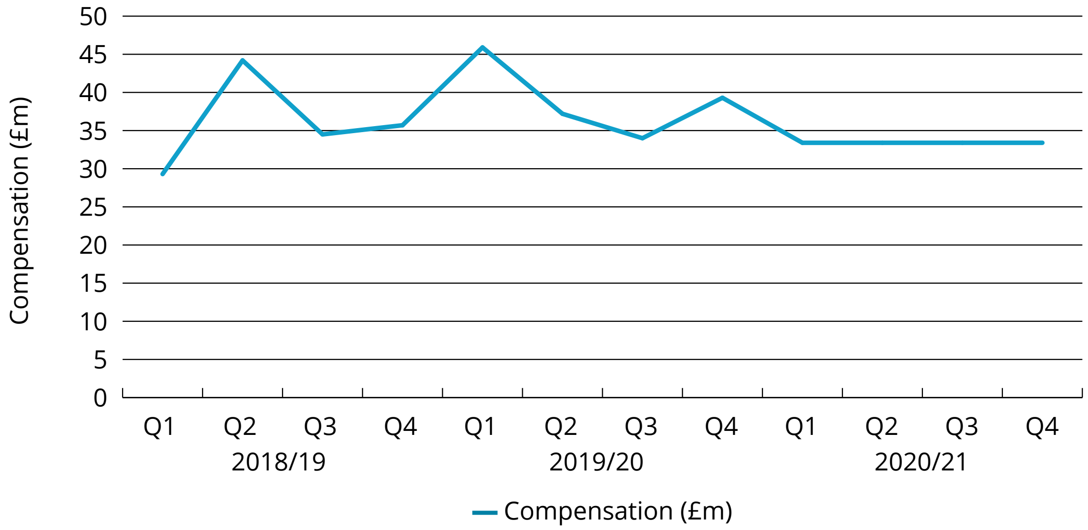


Insurance Provision

During 2019/20 we have seen a slight increase in compensation within the General Insurance class (+£12.7m). The recent failures of Qudos Insurance (December 2018) and Lamp Insurance Co. Ltd (May 2019) have cost £12.4m. Chester Street Insurance Holdings Ltd, Enterprise Insurance Co. Plc, Gable Insurance AG and Alpha Insurance A/S continue to be the largest failures within this class making up 73% of payments.

We are not forecasting any payments for Life Insurance Provision.

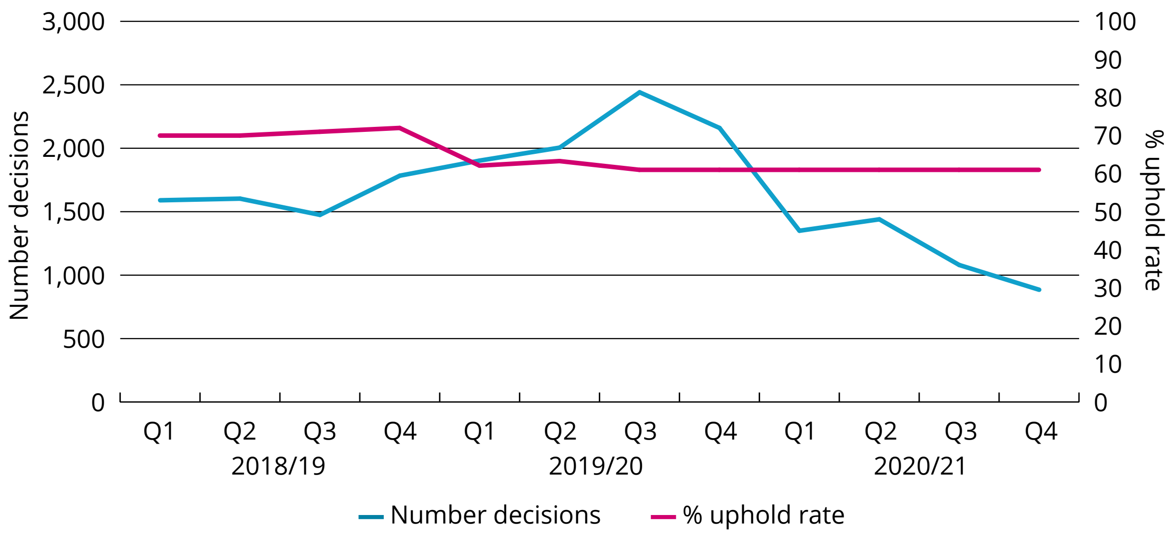
Figure 6: General Insurance Provision payments



General Insurance Distribution

Having experienced an increase in volumes leading up to the PPI complaints deadline, volumes have now started to see a decrease which is expected to continue during next year. We have also experienced a fall in uphold rates, driven by an increase in duplicate claims, since April 2019. This has limited the impact on the levy.

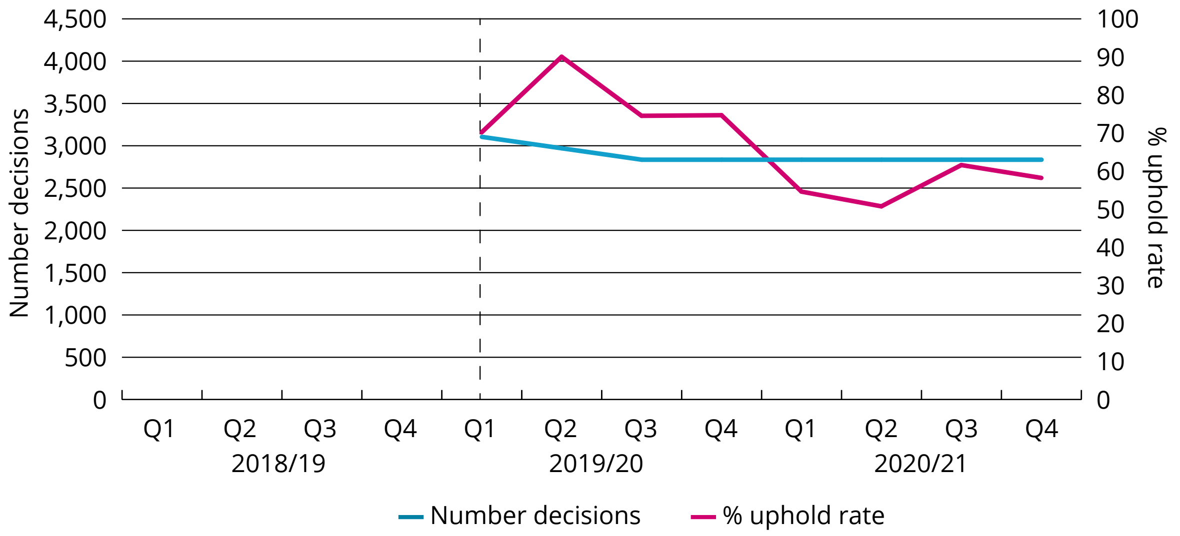
Figure 7: General Insurance Distribution decisions and uphold rate



Life Distribution, Pensions and Investment Intermediation

This year saw the consolidation of Life and Pensions Intermediation and Investment Intermediation into one class. Within the class we experienced an increase in decisions during 2019/20 due to claims against Beaufort Securities Ltd, the largest default within this class. SIPP related claims continue to be the main contribution within the class making up 43% of new claims. Claims for personal pension transfers remain an area of steady increase.

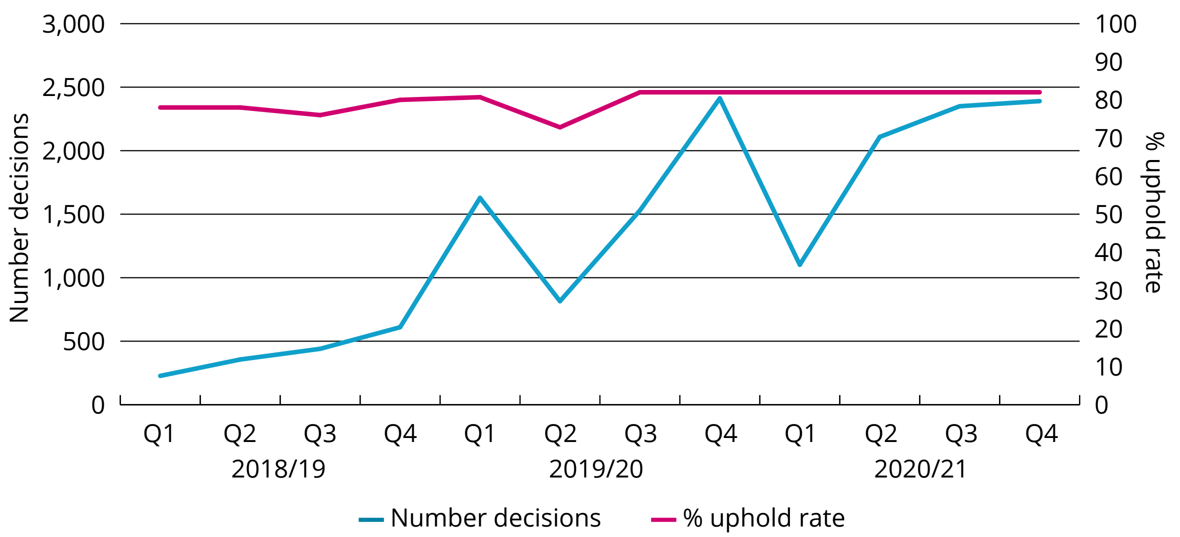
Figure 8: Life Distribution, Pensions and Investment Intermediation decisions and uphold rate



Investment Provision

This class has sustained its increase in claim volumes. This year FSCS has started accepting claims against Berkeley Burke SIPP Administration Ltd, GPC SIPP Ltd, Independent Portfolio Managers Ltd and The Lifetime SIPP Company Ltd. These claims are very complex, and often require legal guidance. We anticipate a marked increase into 2020/21.

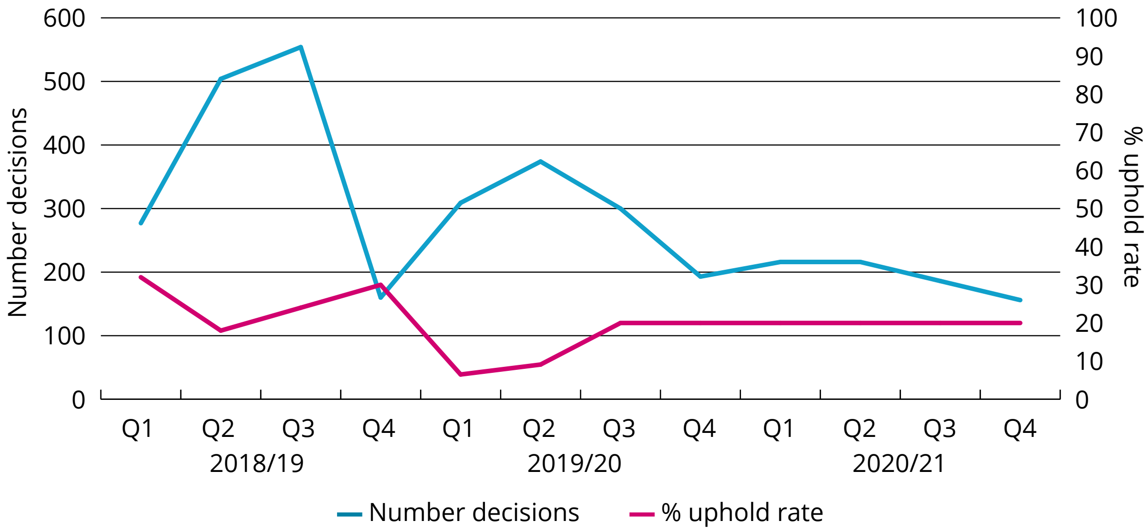
Figure 9: Investment Provision decisions and uphold rate



Home Finance Intermediation

During 2019/20 we have seen an increase in claims due to unsuitable advice mainly for 'interest-only' mortgages. The majority of these have been rejected due to insufficient evidence of negligent advice. This has led to an increase in decisions but a decrease In uphold rate – causing no real impact on compensation costs. The 2020/21 forecast is for these claim volumes to reduce.

Figure 10: Home Finance Intermediation decisions and uphold rate



Debt management

From 1st April 2018 this funding class was created covering the business of debt management firms with a levy limit of £20m. We are not forecasting any claims for 2020/21.

Appendix: A

Figure 11: Comparative costs forecasts - 12 months vs 36 months

Funding Class	2020/21 Forecast (£m)	3-year average (£m)
Deposits	N/A	N/A
General Insurance Provision	133.55	143.75
General Insurance Distribution	7.76	13.88
Life Distribution, Pensions and Investment Intermediation	221.20	239.65
Investment Provision	215.26	52.97
Home Finance Intermediation	8.05	10.67

Appendix: B

Figure 12: Management Expenses by PRA/FCA split

	2019/20			2020/21			Movement		
	FSCS total costs (£m)	Fee block allocation		FSCS total costs (£m)	Fee block allocation		FSCS total costs (%)	Fee block allocation	
		PRA (£m)	FCA (£m)		PRA (£m)	FCA (£m)		PRA (%)	FCA (%)
Base costs total (split 50:50)	**22.7**	**11.3**	**11.4**	**27.7**	**13.9**	**13.9**	**22%**	**23%**	**22%**
Specific costs									
Deposits	12.7	12.7		13.0	13.0		2%	2%	
General Insurance Provision	4.3	4.3		4.8	4.8		12%	12%	
Life and Pension Provision	-	-		-	-		0%	0%	
General Insurance Distribution	7.7		7.7	5.7		5.7	(26%)		(26%)
Life Distribution, Pensions and Investment Intermediation	22.0		22.0	18.8		18.8	(15%)		(15%)
Investment Provision	5.8		5.8	6.8		6.8	17%		17%
Home Finance Intermediation	2.0		2.0	1.3		1.3	(35%)		(35%)
Debt Management	-		-	-		-	0%		0%
Specific costs total	**54.5**	**17.0**	**37.5**	**50.5**	**17.8**	**32.7**	**(7%)**	**5%**	**(13%)**
Management Expenses total	**77.2**	**28.3**	**48.9**	**78.2**	**31.7**	**46.6**	**1%**	**12%**	**(5%)**

Appendix: C

Figure 13: MELL view by standard expense lines

	2019/20 Forecast (£m)	2020/21 Budget (£m)	Variance (£m)
Staff costs	19.5	22.8	3.4
Contractor costs	3.9	1.0	(2.9)
IT	4.8	4.4	(0.4)
Communications	4.0	3.8	(0.2)
Legal and professional	10.1	10.0	(0.1)
External providers	0.5	1.5	1.0
Facilities	2.1	2.2	-
Depreciation	1.5	1.5	-
Other	0.6	0.6	-
Outsource claims	17.1	17.0	(0.1)
Outsource printing	0.3	0.3	-
Change	4.0	4.0	-
Bank charges	6.8	7.2	0.4
Pension	1.9	1.9	-
Provisions	-	-	-
Total	**77.2**	**78.2**	**-**
Unlevied reserve	*Note	5.0	-
Total including unlevied reserve	**77.2**	**83.2**	**1.0**

*Note The forecast of £77.2m includes the utilisation of up to £2.6m of unlevied reserve within the outsourced claims line.

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