

FSCS Response to the DWP Review of Pensions Institutions

What we do

The Financial Services Compensation Scheme (FSCS) is the UK's statutory fund of last resort for customers of financial services firms. FSCS is a non-profit making independent body, created under the Financial Services and Markets Act 2000 (FSMA), which aims to provide an effective and efficient compensation service for UK consumers and help maintain confidence in the financial services industry.

We became operational at N2 (1 December 2001). We can only pay compensation where an authorised firm is unable to do so. We call this being 'in default'. We have declared over 1550 firms in default since N2 and paid out over £940 million in compensation. The compensation figure includes 235,000 insurance payments and payments to over 47,000 other claimants, the majority of which related to investment claims. We have also recovered £320million, as at 31 March 2006, for the benefit of FSCS levypayers, the authorised financial services community.

Our jurisdiction covers the retail business of firms authorised by the FSA (with the exception of mortgage lending). Changes to the scope of the FSA have resulted in changes to the scope of the FSCS. Mortgage Advice and Arranging on or after the 31 October 2004 and Insurance Broking activities on or after 14 January 2005 are new regulated activities now covered by the FSCS. So far claims in these sectors have not been significant in financial terms but we continue to monitor these sectors carefully.

Growth over last 5 years

The operational challenge for the FSCS is to be flexible enough to deal with significant and fluctuating claims volumes, and new and emerging types of business.

The change in our operations over the last 5 years has been dramatic, driven by rapidly rising volumes of endowment claims

In our first full year of operations (2002/03) we completed around 4,000 claims of which 3,355 related to the pension review. This compares to a figure of 25,800 claims completed during 2005/06 of which 16,000 were mortgage endowment claims. We expect the number of claims processed to increase further in the next year.

Claims relating to insurance firm failures are not processed by us. They are usually handled by the appointed run-off agent who then presents them to the FSCS for checking and payment. By way of example 40,750 such payments were made in 2005/06

In response to the change in the volume and nature of claims being received, we have increased our staffing figures from a figure of 116 in 2002/03 to our current figure of 207. We have also changed our resourcing strategy so that we now make significant use of outsourcers to handle claims to complement our in-house teams. This allows us to provide a better service to those who need our help by enabling us to scale up quickly when demand increases. It also lets us scale down again quickly in times of declining claims volumes, managing the cost impact on our levypayers.

Experience with work related pensions

Our experience is limited to the pension review and since N2 we have paid out over £251m to 15,500 pension review claimants mostly into their occupational pension schemes or personal pensions. We have 800 claims in progress and expect over 400 claims next year.

Relationship with the FSA and the FOS

Under FSMA we are operationally independent but accountable to the FSA. We have a close working relationship with the FSA and the FOS with regular meetings, both bilateral and trilateral. We have produced a consumer guide jointly with the FOS and the FSA explaining the distinct roles of our three organisations and how we work together which is available on each of our websites. A copy is attached.

Our collaborative work with the FSA is around understanding likely future claims on the Scheme including product type and specific firm failures, as well as on policy issues affecting us both. We have daily contact between the FSA and FSCS at all levels.

Our contact with the Ombudsman is close but less frequent. With experience, we have identified a need to anticipate policy issues which would be appropriately dealt with by a common approach. Where such issues arise e.g if a new product were likely to cause work for us both, our aim is to work together towards common policies, or an understanding of where different approaches were required by our different remits. We also have systems in place so, in an atypical case where a claim has been transferred from the Ombudsman to the FSCS, there is effective transfer of data and exchange of information between one organisation and the other.

Funding of the FSCS

The way FSCS is funded is governed by FSMA and FSA made under FSMA. As a result of concerns about the current FSCS funding arrangements, a review was set up by FSA in 2005. The FSCS Chief Executive and other senior FSCS staff are closely involved in the review.

FSCS needs a funding structure that is sustainable in the long term across the industry; smoothes volatility in compensation bills and provides sufficient funding to let us get on with the job we are here to do.

A discussion paper was published in March 2006 outlining the options for the new funding regime and a consultation paper is to follow soon. The discussion paper assumed that firms would contribute to compensation costs for failures of firms in their business class.

The discussion paper also proposed the idea that above the broad business classes there could be provision for a general pool, into which all classes would contribute if a single class had been levied to the limits of practicability. The general pool would give the FSCS a fund to draw against in the event of a large scale, possibly systemic failure. The important unifying factor for all contributors to the general pool is their direct need for confidence in the authorised financial services community

Relationship with the Pensions Regulator (TPR) and the Pensions Protection Fund (PPF)

Whilst we have had contact with the Pensions Regulator (PR) and the Pensions Protection Fund (PPF) there has not been the need to develop a day-to-day relationship, given our respective responsibilities. We have no evidence of any confusion about the respective roles and responsibilities of the PPF and the FSCS.

We do have an arrangement with the Fraud Compensation Fund, which as you know is a statutory fund run by the Board of the PPF, as there is the potential for overlap between the Fraud Compensation Fund and the FSCS. A letter of understanding has been exchanged with the DWP as to the operation of each organisation.

FSCS Response to questions raised in your letter of 18 January 2007

Q1

As stated above we have little current involvement with work-based pensions. We would have a role if any authorised provider of advice or pension products were to become insolvent leaving claims unpaid.

Q2

We believe we have a good relationship with both the FSA and the FOS and the current arrangements generally function well. Close contact ensures that we identify and act on areas for improvement as they arise. We do not feel it is appropriate to comment on the functioning of the TPR and the PPF as we have little contact with them.

Q3

We have no evidence there is confusion amongst consumers about the respective roles of the FSCS and the PPF. FSMA outlines the clear and distinct responsibilities of the FSA, FSCS and the FOS and we all work together to make sure consumers understand those roles clearly.

Q4

There are two European Directives that directly affect the role of the FSCS, the Deposit Guarantee Scheme Directive (DGSD) and the Investor Compensation Directive (ICD). The DGSD is currently under review by the Commission and we are working closely with the Treasury and the FSA on this. The Commission is also considering a proposal for a new Insurance Guarantee Scheme Directive and again the FSCS is involved in this work.

These directives do not dictate the institutional configuration of compensation responsibilities, to our knowledge and there are a number of other models in existence, both within Europe and elsewhere. Our own jurisdiction across the retail regulated sector is unique in Europe and one of the strengths we believe of the UK system.