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(please quote this reference when contacting us)

FSCS Financial Services Compensation Scheme

PRIVATE AND CONFIDENTIAL
Mr S Oakes
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7 July 2010

Dear Mr Oakes

Thank you for your letter of 17 June 2010, and your emails of 18 June 2010 and 2 July 2010, about the Financial Services Compensation Scheme (FSCS) levy.

I am sorry that you are unhappy about the amount set for your firm's FSCS 2010/2011 levy. I have now reviewed this matter in line with the first stage of our complaints procedure, in my capacity as Assistant Manager of the Customer Services Team at the FSCS, and I am in a position to respond to your concerns.

As you will be aware, we are the UK's statutory fund of last resort, set up under the Financial Services and Markets Act 2000 (FSMA). Our role is to protect consumers who have lost money after dealings with authorised financial services firms where the firms are unable, or likely to be unable, to meet the claims against them. This will usually be because a firm has stopped trading or is insolvent. The rules for the FSCS, including how the Scheme is funded, are made by the Financial Services Authority (FSA) under the terms of FSMA.

I have noted the points made in your correspondence and fully appreciate your concerns about the impact of FSCS levies on firms such as yours. You have said that you have not received any claims against your company, and feel that the levy is unfair to your business.

The current FSCS funding system started on 1 April 2008 following a review conducted by the FSA. At the time changes were made by the FSA to increase the funding capacity of FSCS, and to ensure that the FSA meets its primary duty of setting up a compensation scheme that provides adequate levels of protection to consumers. The changes were made after due consultation with the financial services industry, and financial advisers therefore had the opportunity to provide their comments regarding the funding model at that time.

FSCS operates under the rules by which it is governed, including those relating to the levy which are detailed in the 'FEES' section of the FSA Handbook (http://fsahandbook.info/FSA/html/handbook/FEES). However, these rules are made by the FSA. Consequently, we are not in a position to exercise any form of discretion as to whether or not to apply those rules, or to apply different rules. Whilst I have noted your comments, and appreciate that you are unhappy with the increase, there is no provision in FEES to waive a firm's levy simply because it has not received a claim against it.

FSCS's costs are levied under two separate arrangements:

(i) Management expenses:

- Base costs – the costs of running the Scheme, assuming no claims are processed – broadly our fixed costs
- Specific costs – the costs of claims handling or other costs associated with a particular default, and

(ii) Compensation costs – for example, the amounts paid to claimants in compensation

For funding purposes, authorised financial services firms are allocated to classes based on their regulatory permissions. These classes are: deposits, life and pensions, general insurance, investments, and home finance. With the exception of the deposits class, each broad class is divided into two sub-classes based on provider/intermediation activities. Each of the "sub-classes" is made up of firms which are providers or intermediaries and engage in similar styles of business with similar types of customer.

In your email you have requested clarification regarding the increase in your FSCS levy 2010/2011. In the first instance, you may find it helpful to visit the Industry section of our website, and in particular the Publications section, (http://www.fscs.org.uk/industry/publications/) and Industry News section, (http://www.fscs.org.uk/industry/news/2010/), and the levy press release dated 29 March 2010 (http://www.fscs.org.uk/industry/news/2010/march/fscs-announces-2010-11-levy-and-3dq5rm1q/. These sections explain the reasons why financial firms have seen significant increases in their FSCS levy for 2010/2011. If you believe that any of the details on your FSA invoice is incorrect, you should contact the FSA directly.

You have specifically asked why your levy has gone up by 1800% if insurance intermediaries have been affected by a 21% increase. However, your understanding of the position is not correct, as I shall explain below. The figure of £50.5m was not the SB02 levy for last year, as you have assumed. It was, in fact, the indicative levy published in the Plan and Budget this year for the current year, and not the corresponding figure for last year. The increase from £50.5m to £61.4m resulted because we did not raise an interim levy in March for PPI claims, as had originally been anticipated in the Plan and Budget. These figures were therefore carried forward into the main levy in June, thereby inflating the June levy. Our press release of 29 March 2010 anticipated this outcome in the following terms:

"At the same time, the FSCS has decided insurance intermediation firms will not receive an interim levy in 2009/10 for the costs of payment protection insurance (PPI) claims. After refining its assumption and estimates for the current year, these costs will be levied in 2010/11. PPI claims are becoming a growing area of the FSCS's work and will be one of the main drivers of costs in 2010/11, according to the FSCS. The FSCS has set the 2010/11 general levy at £148m. More than £61m of this will go to firms in the General Insurance Intermediation sub-class, mainly to cover the costs of PPI claims."

In 2009/10 the levy for the General Insurance Intermediation sub-class (SB02) was £8.5m.

The amount levied for compensation payments is the amount of compensation paid, plus an estimate of the compensation costs we expect to pay in the 12 months following the levy date, assumed to be 1 July each year, allowing for any retained fund balances.

Your specific question regarding the increase in SB02 category claims for comparable firms should be addressed to the FSA, as this is not within our remit, and we do not have the relevant information to give you in this respect. The same applies to your question about the calculation of the increase.

From the above I hope you will appreciate that the FSCS levy applied to your firm relates to the activities of firms in the SB02 category that are no longer trading, and for which the FSCS has assumed responsibility for the review of claims. As a result it is not correct to say that you are paying for the "inefficiency, mis-management and financial problems within extremely large banking, investment and insurance firms". The compensation payable for those claims mainly falls under different sub-schemes and different levy sub-classes.

We hope that firms do recognise the value of having a fund of last resort for consumers, as this helps maintain confidence in the sector and encourages people to do business with authorised financial services firms. Our challenge is to ensure we meet the needs of those consumers who qualify for our protection, whilst ensuring that we operate efficiently and economically having regard to the costs which must be borne by the industry.

The FSA recently announced that there would be a full review of the FSCS funding model which will take place this year. This review will consider all aspects of FSCS funding including ex-ante funding, risk-based levies, the split between funding classes etc. If you have views on the current funding model, or on the application of FEES to APFs, may I suggest you write to the FSA, explaining your thoughts on this matter.

I trust this helps clarify the position. If you have any further questions please telephone myself or one of my colleagues on 020 7892 7300 or freephone on 0800 678 1100, and we will be pleased to assist you.

Yours sincerely

Tom Sheffield
Assistant Manager