

FSCS Levy

The FSCS is funded by the financial services industry. Every firm authorised by the UK regulators is obliged to pay an annual levy, which goes towards the running costs and the compensation payments.

The FSCS published its plan and budget for 2016/7 in January 2016. The plan revealed details of a £363m indicative levy on firms for the period, forecasted the FSCS's management costs falling by nearly £2m and highlighted internal organisational changes that aimed to improve the customer experience.

In April 2016, the FSCS announced its levy for 2016/17. FSCS will levy £337m in this financial year, £26m less than forecast in its Plan and Budget for 2016/17, published in January. The levy in 2015/16 totalled £319m. Management expenses fall for the second successive year. In 2016/17, these will total £67.4m.

Most industry sectors will contribute less in 2016/17 than FSCS forecast in January. The exception is the life and pensions intermediaries sector, which will pay a levy of £90m in 2016/17 – up from a forecast of £80m, to reflect a higher average cost of claims arising from advice about investments in self-invested personal pensions (SIPPs). In 2015/16, life and pensions intermediaries paid a levy of 100m.

In July 2016, the FSCS announced that some 47,000 people turned to FSCS in the twelve months to March 2016, after they lost money when their financial services firm was unable to settle claims. FSCS paid out £271m in 2015/16 in response to 45,900 claims.

FSCS compensated consumers across a wide range of financial services:

- Almost £88m was paid to customers of firms providing general insurance – such as motor and employers' liability insurance;
- Claims against the life and pensions advice sector led to a compensation bill of just less than £84m, up from £35m the previous year – largely because the average pay-out against advisers who recommended high-risk investments to hold in self-invested-personal pensions, or SIPPs, rising year-on-year from £29,500 to £38,600.
- £77m was paid out to people with claims against financial advisers that later stopped trading.

Financial Advice Market Review – published in March 2016

It is crucial that consumers receiving financial advice

- have confidence in the regulatory system
- have access to redress if they are wrongly advised.

FAMR believes that the existence of appropriate protection for consumers is essential to ensuring they feel confident in taking up financial advice. However, it is also clear that the potential risk of paying redress in the future on advice given previously is a concern for many firms.

One specific issue that firms have identified is that the unpredictable nature of the Financial Services Compensation Scheme (FSCS) levy makes it hard to plan effectively, and that the cost in funding the levy is not necessarily being borne by those that create costs for the scheme.

The FCA is to commence a review of how the FSCS is funded in 2016. FAMR recommends that this should explore:

- risk-based levies
- reforming the FSCS funding classes
- whether contributions from firms could be smoothed by making more extensive use of the credit facility available to the FSCS

Following its review of FSCS funding, and in the light of the evidence from that review, the FCA should consider whether there is a case to look further at the professional indemnity insurance (PII) market in relation to the suitability and availability of cover for smaller advice firms.

The FAMR also dealt with other issues

- the lack of a longstop after which consumers cannot complain about financial advice.

FAMR has considered the case for a blanket fifteen-year limit on liability for financial advice and has concluded that this would not be in the interest of consumers, especially given the risks that arise with long-term products.

- the fairness of the FSCS levy.

Under the current funding model, a firm's levy is proportionate to the size of their annual eligible income and the amount of FSCS compensation accrued by their individual funding class. Each firm is placed in the FSCS funding class that best matches the services they provide, such as general insurance intermediation, and sees them contribute to the FSCS compensation costs created by their industry peers.

- the FSCS levy does not reflect whether a firm is engaged in specific complex and higher risk activities

Why should the wider advice industry should pay for the compensation costs incurred by a minority of firms? FAMR has therefore concluded that there is merit in considering possible ways to redesign the levy without reducing consumer undertake funding reviews of the FSCS.

Summary

The FSCS is the backstop part of the structure of consumer protection within financial services. The rules are set out by the FCA and PRA. The rules should be followed by all registered intermediaries and the intermediaries are covered by Professional Indemnity Insurance. If things go wrong for the registered firm, then the FSCS is there to covered the uninsured liabilities.

Consumer protection is paramount, but the problem is "who should pay for it?". The paradox is that the main costs of the FSCS are the claims that are paid out on behalf of firms that are no longer paying into the scheme and the scheme is funded by all the firms who receive no benefit from it.

The review is looking into how this situation can be made fairer for all concerned.

Should firms operating in higher risk areas pay more?

Should firms with histories of upheld complaints against them pay more?

Certainly, it would seem to be logical to go down a risk based or product based level of tariff. However, this could lead to advice gaps. As advisers may well avoid advising in the higher risk areas in order to keep costs down. Advisers already exercise this choice as they tend to be governed by

their PI cover providers in this respect. The networks already do this to make supervision more straightforward and to minimise their liabilities.

The complaints records may well be a fairer way of calculating the levies. It could be argued that a firm that has complaints upheld by the FOS has caused customer detriment. This may well be an indicator that the firm's business quality may not be good enough. If a firm has too many complaints, then it will struggle to obtain PI cover and therefore may stop trading. Or the level of compensation payments may well cause it to stop trading. Either way, further claims are likely to end up being covered by the FSCS.

The FCA changed the complaints recording and reporting rules in June. This will lead to more accurate records of complaints being visible to the FCA as complaints are recorded in the GABRIEL returns. The firms with significant complaint histories should be treated differently to those that make "nil returns" year after year.

Either way, the system is still largely funded by firms who are behaving well and giving good client outcomes. This should be changed to ensure that higher risk firms pay more into the system.

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