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Financial Services Compensation Scheme

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Summary

This note outlines the background to and scope of the financial services compensation scheme (FSCS). Significant changes were made to the scheme in the summer of 2007 following the emergence of financial difficulties at the Northern Rock bank and in October 2008 following continued difficulties in the UK banking sector.

The note also describes how the failure of Icelandic banks was dealt with within the FSCS framework

1. Establishment

The Financial Services Compensation Scheme was created by Part XV of the *Financial Services and Markets Act 2000* (FSMA) and has been operating since December 2001. It replaced five previous compensation schemes, including the Deposit Guarantee Scheme (which covered bank deposits); a similar scheme for building societies; the Policyholders Protection Board (which protected insurance policyholders); and the Investors Compensation Scheme (which protected customers of investment businesses that were authorised under the *Financial Services Act 1986*).

The underlying principle of the FSCS and of its predecessor schemes is that while financial institutions should generally be responsible for meeting their own liabilities, it is desirable to create a fund of last resort which can be called on to protect investors and depositors when an institution can no longer meets those liabilities.

As the first consultation document on establishing the FSCS noted, such a fund has benefits beyond investor protection and helps contribute to confidence in the financial services sector and to systemic stability:

> The provision of compensation to consumers where firms fail to meet their liabilities is integral to the protection of investors, depositors and policy-holders, and plays an important part in promoting confidence in financial institutions as well as in the financial system as a whole. The justification for establishing compensation schemes is that individual investors, depositors and policyholders are not generally in a position to make an informed assessment of the risk that the firm to which his or her funds are entrusted may fail. As well as providing protection in the last resort for consumers, the existence of compensation schemes also helps to reduce the systemic risk that a single failure of a financial firm may trigger a wider loss of confidence in the rest of the financial sector concerned (e.g. through a run on deposit-taking institutions).[1]

It is frequently asked whether the compensation limit applies to each depositor or each account held by each depositor. The compensation limit applies to each depositor for the total of their deposits with an organisation, regardless of how many accounts they hold or whether they are a single or joint account holder. In the case of a joint account, FSCS will assume that the money in that account is split equally between account holders, unless evidence shows otherwise. This means that each account holder in a joint account would be eligible for compensation up to the maximum limit.

1 Financial Services Authority, *Consumer compensation*, CP5, December 1997

2. The FSCS in practice

2.1 Pre-Northern Rock

In order to limit the cost of the FSCS and to minimise the risk of moral hazard, the scheme has strict eligibility criteria which must be met before the scheme will step in. Before September 2007, eligible liabilities under the scheme were not paid in full (except for some small claims) and a ceiling for claims applies. This means that investors were expected to bear some of the risk of default themselves. In addition, the scheme is only open to consumers and to small businesses (with a few exceptions). The predecessor schemes set different levels and different ceilings for compensation. Although the rules were modified when the FSCS was created, it still runs three sub-schemes, dealing with deposits, insurance and investments respectively. The sub-schemes have different levels of cover as the following extract from the FSCS website explains:

> **Deposits**
>
> FSCS provides protection for customers of deposit-taking firms (for example banks, building societies and credit unions). The Scheme is triggered when an authorised firm goes out of business.
>
> The Scheme may also be triggered when the FSA considers that an authorised firm is unable to repay its depositors, or is likely to be unable to do so.
>
> The maximum level of compensation you can receive from the Scheme for a deposit claim is £31,700 (100% of £2,000 and 90% of the next £33,000).
>
> The compensation limit applies to each depositor and covers the total of all their deposits held with that firm. Each individual in a joint account is eligible to receive compensation up to the maximum limit in respect of their share of the deposits (FSCS will assume the split is 50/50 unless evidence shows otherwise).
>
> **Investments**
>
> The Scheme covers two kinds of loss:
>
> when an authorised investment firm goes out of business and cannot return your investments or money;
>
> loss arising from bad investment advice, or poor investment management.
>
> The maximum level of compensation you can receive from the Scheme for a claim against an investment firm is £48,000 (100% of £30,000 and 90% of the next £20,000) per person.
>
> **Insurance**
>
> Policyholders are protected if they are insured by authorised insurance firms under contracts of insurance issued in the UK, or in some cases in the EEA, Channel Islands or Isle of Man. The Scheme covers compulsory, general and life insurance and is triggered if an insurance firm goes out of business or into liquidation.
>
> The maximum level of compensation you can receive from the Scheme for a claim against an insurance firm depends on the type of insurance policy, as described here.

> FSCS may arrange to transfer your policy to another insurer, provide a new policy or, if these actions are not possible, provide compensation.
>
> Compulsory insurance, such as third party motor insurance, is covered in full.
>
> Non-compulsory insurance (such as home insurance): the first £2,000 of a claim or policy is protected in full. Above this threshold, 90% of the rest of the claim or value of unused premiums will be met.
>
> Long-term insurance (such as pension plans and life assurance): the first £2,000 of a claim is protected in full. Above this amount, the Scheme covers payment to 90% of the value of a policy in liquidation.[2]

The FSCS acts as a guarantee fund for all firms which are authorised by the FSA. The FSCS's resources are drawn from the authorised community by means of a levy on regulated firms. The levy is structured so that while all firms contribute to the normal running costs of the FSCS on the same basis, the costs of handling and paying compensation claims are allocated to the contribution-group to which the defaulting firm or firms belonged. This means that, for example, the cost of paying for the insolvency of a general insurance company is borne by other general insurance companies. There are rules which limit the size of the total annual levy on firms.

Since it was first established two other sub-schemes have been introduced, one for pensions and another for mortgage sales and advice. Full details of the compensation scheme can be found in the FSA Handbook.

2.2 Post-Northern Rock, September 2007

The emotive back-drop of depositors queuing to withdraw their savings from high street branches of the Northern Rock bank, prompted support activities from the authorities. On the 14 September 2007 the Treasury announced liquidity support for Northern Rock. Further announcements followed on the 17 and 20 September and 9 October.

In tandem with these initiatives on 1 October the FSA announced changes to the FSCS. The change meant that all deposits up to £35,000 would now be covered by 100% protection. This change only impacted upon the depositors' protection scheme, losses from insurance or other sectors did not have their protection improved.

The change to the rules was done by way of a change to the Rule book. As allowed under FSMA, in times of emergency the FSA can make rule changes without the standard consultation process normally required under the Act. The new rules can be found in the Compensation section of the Redress part of the full FSA Handbook.[3]

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2 FSCS website

3 Specifically Comp 10.2 http://fsahandbook.info/FSA/html/handbook/COMP/10/2

2.3 Further increase in deposit protection, October 2008

The FSA increased the compensation limit for bank deposits from £35,000 up to a total of £50,000 for each customer's claim from 7 October 2008. Customers with joint accounts will be eligible to claim up to £100,000. In a press notice accompanying the announcement, Hector Sants, the FSA's chief executive officer, said:

> "There has been extensive debate about the compensation levels. In the interests of providing clarity over the minimum level for the long term we have now decided to implement the move to a £50,000 limit from Tuesday.
>
> "This change ties in with the introduction of the Government's Banking Bill in Parliament which is due next week, and is also appropriate given the consolidation that has taken place in the banking sector.
>
> "In addition, the Chancellor has made clear that the Authorities will do whatever is necessary to maintain financial stability and protect depositors."
>
> The Government will shortly be introducing legislation to further enhance consumer confidence in the banking sector.
>
> The FSA is also to consult on further reforms, including considering whether the compensation limit should be higher still; the speed with which the FSCS can pay compensation; and the rules surrounding whether deposits are covered on a legal entity, a 'brand' or an 'account' basis.
>
> This will provide effective long-term compensation arrangements in which consumers can have confidence.
>
> The changes to the compensation limit are detailed in the Financial Services Compensation Scheme: Review of limits consultation paper which is published today. The paper also sets out proposals to improve the overall scheme and to ensure consistency in respect of compensation limits for investment, insurance and home finance.[4]

In relation to the limits on insurance claims, the compensation paper proposed removing "the lower level of coverage of 100% of the first £2,000, and so the future level of cover will be 90% of the total claim, again without any upper limit."[5]

On the *Today Programme* on 8 October 2008 the Chancellor, Alistair Darling, stated, in relation to guaranteeing bank deposits:

> What we do in relation to that will differ from institution to institution…what I will do is in every single case and every single instance…I have been very clear I have never ruled anything out.[6]

This would appear to indicate that although the Government was keen to avoid blanket guarantees, in effect all savings were safe. All deposits in Northern Rock, Bradford & Bingley, the Icelandic based banks and

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4 FSA press notice, "Compensation scheme to cover savers' claims up to £50,000", 3 October 2008; consultation paper CP08/15mentioned above is available here.

5 Financial Services Authority, Financial Services Compensation Scheme: Review of limits, Consultation Paper 08/15, October 2008, para 1.12

6 BBC 'Today' programme.

London Scottish bank were at one stage eligible for complete protection. The retail deposit side of Bradford & Bingley is now subsumed within the normal arrangements for its new owner Santander (Abbey). The Icelandic banks have gone into insolvency and depositors' deposits were guaranteed in full.[7] The Northern Rock 100% guarantee will cease from 24 May 2010 and will revert to the normal £50,000 limit.[8]

Individuals with 'money' in a bank or building society may find themselves with protection from different schemes. For example, a deposit account is treated separately from a stocks and shares ISA. The deposit account will be covered by the £50,000 guarantee on bank deposits. The ISA will be covered as an investment, the limits being 100% of the first £30,000 and 90% of the next £20,000, giving a total protection of £48,000

A table summarising the official levels of protection on different classes of asset is shown below:[9]

[7] See Standard Note SN/BT/4864 for more details
[8] See Treasury statement 24 February 2010
[9] Source: FSA Handbook Comp 10.2.3

Type of claim	Level of cover	Maximum payment
Protected deposit	[1] **100% of** *claim* [1]	[11, 3]**£50,000**[3]
Protected contract of insurance **when the contract is a** *relevant general insurance contract*	**(1) Where the claim is in respect of a liability subject to compulsory insurance: 100% of claim.**	**Unlimited**
	(2) Where the claim arises under the Third Party (Rights against Insurers) Act 1930, is in respect of a liability within COMP 5.4.5R(1)(b), and is in connection with an Article 9 default: 90% of the claim.	**Unlimited**
	(3) In all other cases: **100% × first £2,000** **90% of remainder of the claim.**	**Unlimited**
Protected contract of insurance **when the contract is a** *long-term insurance contract*	100% × first £2,000 At least 90% of the remaining value of the policy as determined in accordance with COMP12.	Unlimited 2
Protected investment business	**100% × first £30,000 90% × next £20,000**	**£48,000**
[4]*Protected home finance mediation* [45]	100% × first £30,0005 90% × next £20,0005	£48,000 5
Protected non-investment insurance mediation [6]	(1) where the *claim* is in respect of a *liability subject to compulsory insurance*: 100% of *claim* [6]	Unlimited6
	(2) In all other cases: 100% x first £2000 90% of the remainder of the claim6	Unlimited6

Another confusion can arise when a bank is part of a wider banking group. Compensation depends on the bank being registered and having its own licence, so if it is part of a larger group the parent can hold the licence on its behalf. Accounts held in different parts of the group will all count towards the same £50,000 protection. The FSA has produced a table which summarises the main banking groups thus highlighting when the protection level is likely to be single or multiple values of £50,000; this is shown in the Appendix to this note.

2.4 EEA and Icelandic banks

Someone with an account in a UK branch of a bank incorporated in the European Economic Area (EEA) that becomes insolvent, may receive help from the FSCS. The website states:

> Under the EU Deposit Guarantee Schemes Directive, all member states of the EEA are required to establish a deposit guarantee scheme which gives a minimum level of protection for depositors of 20,000 Euros per eligible depositor in the event of a bank failure.
>
> A bank established in another EEA state should be a member of that state's compensation scheme, which is designed to protect depositors in that EEA country, and those with accounts at branches in other EEA countries. Where the bank's home state scheme provides a lower limit of compensation than FSCS (i.e. less than 100% of £50,000), or the scope of protection is less than FSCS's, the bank may choose to join FSCS to 'top up' the level of protection offered by the home state scheme. The link below leads to a list of banks that have topped up into the UK Scheme with their FSA reference numbers and the month and year FSCS or the predecessor scheme accepted their application to top up.
>
> In the event of a failure of one of these banks, there would be a two step process as the home state scheme would have lead responsibility for claims, and would be responsible for paying the first part of any compensation. FSCS is only responsible for paying compensation for the topped up element to £50,000 on deposits with the UK branch. FSCS would, wherever possible, try to assist claimants in their dealings with the home state scheme (for example, by putting them in contact with the home state scheme, or helping them understand the process that the home state scheme will follow). FSCS would then deal with any 'top up' claims.[10]

A list of the firms that have topped up into the UK Scheme is available on the FSCS website.

The FSCS had the responsibility for compensating Icelandic banks operating in the UK when they went into administration. The FSCS produced the following explanation just before the Icesave and Heritable banks ceased trading:

> The Financial Services Authority in the UK has reported that Icesave is now expected to go into insolvency proceedings in Iceland and this would trigger an FSCS default.
>
> Eligible savers with Icesave are protected by the Icelandic Depositors' and Investors' Guarantee Fund (IDIGF), up to a limit of the first 20,887 euros of their deposits. As an Icelandic bank Icesave is not automatically a member of the FSCS, but it opted to become a 'top-up' member. This means that eligible retail savers with Icesave's UK branch whose savings exceed the Icelandic limit would benefit from top-up compensation from the FSCS covering the amount over the Icelandic limit up to the new FSCS compensation limit for deposits of £50,000.
>
> If the default is triggered as expected, FSCS will contact all UK savers directly with details of how to apply for compensation.[11]

This was confirmed on 8 October when the Treasury confirmed that the Government intended to make sure that no retail depositor lost any money as a result of the closure of Icesave or Heritable. The Treasury press notice is reproduced below:

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10 http://www.fscs.org.uk/consumer/faqs/deposit_claims_faqs/

11 http://www.fscs.org.uk/consumer/; information on the IDIGF is available at: http://www.tryggingarsjodur.is/

1. Acting on the advice of the Bank and Financial Services Authority (FSA), and in light of announcements made by the Icelandic authorities in recent days, the Chancellor has taken action today to protect the retail depositors in two Icelandic owned banks: Icesave, a UK-based branch of Landsbanki and Heritable, a UK-based banking subsidiary of Landsbanki. He has taken this action to ensure the stability of the UK financial system. Savers' money is safe and secure.

Landsbanki/Icesave

2. The UK authorities expect that Landsbanki will soon be declared in default. Should that occur, the Chancellor has put in place arrangements to ensure that no retail depositor will lose any money as a result of the closure of Icesave. The Treasury and the Financial Services Compensation Scheme are working with the Icelandic authorities and their Deposit Insurance Scheme to ensure that depositors are paid back as quickly as possible. The Chancellor has also spoken to the Icelandic Finance Minister about the importance of the Icelandic authorities ensuring that UK depositors in Icesave are given the same protections as depositors in Iceland and receive their deposits back in full promptly.

3. Arrangements are being put in place to ensure that all ISA customers of Icesave will continue to benefit from the tax-free status of their accounts.

4. The Chancellor has also today taken steps to freeze assets of Landsbanki in the UK until the position with respect to the future of the firm and UK creditors becomes clearer.

Heritable

5. Heritable is regulated by the FSA. The FSA has determined that Heritable no longer meets its threshold conditions, and is likely to be unable to continue to meet its obligations to depositors. The FSA concluded that it is in default for the purposes of the Financial Services Compensation Scheme. The Treasury has used the Banking (Special Provisions) Act 2008 to ensure a resolution that preserves financial stability and provides protection and continuity of business for depositors.

6. Heritable's retail deposit business has been transferred to ING Direct, a wholly-owned subsidiary of ING Group. ING Direct is working to rapidly ensure that it is business as normal for all customers.

7. This action by the Tripartite Authorities protects savers' money and provides certainty for retail depositors. The transfer of the retail deposit book has been backed by cash from HM Treasury and the Financial Services Compensation Scheme.

8. The remainder of Heritable's business has been put into administration. Any retail depositors eligible to claim under the Financial Services Compensation Scheme whose business has not been transferred to ING will be paid out in full through the Financial Services Compensation Scheme.

9. This is the right course of action to protect savers, ensure financial stability, and safeguard the interests of the taxpayer.

Notes to Editors

These notes set out in further detail the arrangements announced today by HM Treasury to safeguard deposits with Heritable.

> By orders made under the Banking (Special Provisions) Act 2008, all retail deposits with Heritable have been transferred to ING Direct.
>
> Retail deposits with Heritable means the credit balances on the following deposit accounts and retail bonds: retail Fixed Rate Bonds; 50+ Saver; 60 Day Notice; 90 Day Notice; 120 Day Notice, Online Saver; Direct Saver and Easy Access.
>
> ING Direct N.V. is a wholly-owned subsidiary of ING Group N.V., the Dutch holding company of an international banking and insurance group, with branches in London and elsewhere. The group has over 85 million customers worldwide, and is one of the 20 largest financial institutions in the world.
>
> ING Direct already has over 1 million customers in the UK using its online banking services.[12]

The Treasury further announced that the Chancellor had taken action to protect the retail depositors in Kaupthing Singer & Friedlander (KS&F), a UK-based banking subsidiary of Kaupthing Bank:

> 1. Acting on the advice of the Bank and FSA, and in light of announcements made by the Icelandic authorities in recent days, the Chancellor has taken action today to protect the retail depositors in Kaupthing Singer & Friedlander, a UK-based banking subsidiary of Kaupthing Bank. He has taken this action to ensure the stability of the UK financial system. Savers' money is safe and secure.
>
> 2. Kaupthing Singer & Friedlander (KSF) is regulated by the FSA. The FSA has determined that Kaupthing Singer & Friedlander no longer meets its threshold conditions, and is likely to be unable to continue to meet its obligations to depositors. The FSA concluded that KSF is in default for the purposes of the Financial Services Compensation Scheme. The Treasury has used the Banking (Special Provisions) Act 2008 to ensure a resolution that preserves financial stability and provides protection and continuity of business for depositors.
>
> 3. KSF's Kaupthing Edge deposit business has been transferred to ING Direct, a wholly-owned subsidiary of ING Group, which operates through its branch in the UK. ING Direct is working to rapidly ensure that it is business as normal for all customers.
>
> 4. This action by the Tripartite Authorities protects savers' money and provides certainty for retail depositors. The transfer of the retail deposit books has been backed by cash from HM Treasury and the Financial Services Compensation Scheme.
>
> 5. The remainder of Kaupthing Singer & Friedlander business has been put into administration. Any retail depositors eligible to claim under the Financial Services Compensation Scheme whose business has not been transferred to ING Direct will be paid out in full through the Financial Services Compensation Scheme.
>
> 6. This is the right course of action to protect savers, ensure financial stability, and safeguard the interests of the taxpayer.
>
> **Notes to Editors**
>
> 1. These notes set out in further detail the arrangements announced today by HM Treasury to safeguard deposits with Kaupthing Singer & Friedlander (KSF).

[12] HM Treasury press notice, "Landsbanki, Icesave and Heritable", 8 October 2008

2. By orders made under the Banking (Special Provisions) Act 2008, all deposits with KSF that relate to Edge accounts have been transferred to ING Direct.

Deposits with KSF other than Edge Accounts

3. The government will ensure that all retail deposits with KSF, which do not relate to Edge accounts (non-Edge retail deposits), will be repaid to depositors who are eligible to claim under the Financial Services Compensation Scheme, including in respect of deposits in excess of the £50,000 limit under the Scheme, with the government covering deposits in excess of the FSCS limit.

4. The Financial Services Compensation Scheme working with the administrator of KSF will endeavour to contact these individuals and make payments to them as soon as possible.

5. All non-Edge retail depositors will receive payments of the gross amounts of the balances on their accounts.

6. Retail deposits for these purposes means the credit balances on Kaupthing Edge Savings Accounts and Kaupthing fixed term deposit accounts held by persons who are eligible to claim under the FSCS (such persons include most private individuals and some small businesses and charities; for further details, please see Chapter 4 of the FSA's Compensation Sourcebook or the website of the FSCS (www.fscs.org.uk)).

7. It will be a condition of payment under these arrangements that a non-Edge retail depositor must assign his claims against KSF to FSCS or to such other person as HM Treasury may require, which will account to HM Treasury for recoveries, which it makes as a result. No further sums will be paid to such non-Edge retail depositor.

8. These arrangements supplement, but do not replace, the FSCS (which covers in full the first £50,000 of financial loss in respect of retail deposits).

ING Direct

9. ING Direct N.V. is a wholly-owned subsidiary of ING Group N.V., the Dutch holding company of an international banking and insurance group, with branches in London and elsewhere. The group has over 85 million customers worldwide, and is one of the 20 largest financial institutions in the world. 10. ING Direct already has over 1 million customers in the UK using its online banking services.

FSCS

11. The FSCS has financed its payout through a loan from the Bank of England.

12. The Chancellor of the Exchequer today restates that the Government stands behind the FSCS, so that it can be relied upon to be able to play its role in meeting future claims that arise.[13]

While the measures announced by the Chancellor include personal bond holders, non-personal bond holders (e.g. local authorities) do not appear to be covered.

[13] HM Treasury press notice, "Kaupthing Singer & Friedlander", 8 October 2008

3. FSCS and pensions

There are three schemes that may provide compensation to pension scheme members. Which applies depends on the type of pension and the circumstances of any loss:

- The Pension Protection Fund (PPF) which was established by the *Pensions Act 2004* to pay compensation to members of eligible defined benefit pension schemes, when there is a qualifying insolvency event in relation to the employer and where there are insufficient assets in the pension scheme to cover PPF levels of compensation.[14]
- A Fraud Compensation Fund, established by the *Pensions Act 2004,* may provide "compensation to occupational pension schemes suffering financial losses that can be attributable to dishonesty."[15]
- The Financial Services Compensation Scheme (FSCS) covers the retail business of firms authorised by the Financial Services Authority (FSA). It can only pay compensation where an authorised firm is unable to do so (is "in default").[16]
- The way in which the FSCS applies to pension savings is complex. As explained above, it has three sub-schemes, relating to deposits, investments and insurance.[17] The Pensions Advisory Service (which is funded by DWP to provide information and guidance to the public on pension issues) explains that which of these sub-schemes applies depends on the nature of the investment. As regards personal pension plans, for example, it says:

> Personal Pension Plans include Stakeholder Schemes and Self Invested Personal Pensions (SIPPs). All PPPs are operated by companies which are authorised by the financial regulator, the FSA. These normally are insurance companies and investment houses. In the case of SIPPs, some of these are operated by firms of Independent Financial Advisers (IFAs).
>
> If one of the plan providers were to go into liquidation, the level of protection for the pension plan member depends on the nature of their investment.
>
> Unitised Funds (except Unitised With-Profit Funds)
>
> These funds are held under trust for the benefit of the investors, the unit holders. They are therefore not available to the creditors of the PPP provider and are not at risk by the provider going into liquidation or receivership. The nature of most of these Funds is that they are invested in Shares, UK or overseas, and they will be hit by downturns in the relevant markets. There is no protection against this type of fall in the value of your pension saving.
>
> With Profit Funds (Unitised or otherwise)

[14] For more information, see the Pension Protection Fund website; and SN/BT/3917, 'Pension Protection Fund'

[15] For more information, see the Pension Protection Fund website and SNBT, 2619, 'Pensions: Fraud Compensation Fund'

[16] FSCS Response to the DWP Review of Pensions Institutions, 9 February 2007

[17] An overview of the scheme can be found in FSCS leaflet, How we can help, Financial Services Compensation Scheme

These Funds are only run by insurance companies and we believe that they are at risk should the insurance company go into liquidation. In this case application can be made to the FSCS for compensation. It is also our understanding that the compensation basis will be that which applies to Investments, i.e. 100% of the first £30,000 and 90% of the next £20,000. The maximum amount of compensation will be £48,000.

Share portfolios

This would only be found in SIPPs. The beneficial ownership of the shares lies with the trustees who hold them, in trust, for the SIPP member. As such, if the SIPP provider were to go into liquidation, these assets are not available to the creditors of the provider and so the questions of loss and compensation should not arise.

Such investments are of course vulnerable to loss due to falls in the stock market. Individual shares can also become worthless because the company concerned has failed. There is no compensation to cover either of these situations.

Deposits

This is a more complicated situation due to the variation of practice by different providers. If the cash is held in a Bank in an account in the name to the individual plan (this is only likely to apply to a SIPP), the FSCS protection up to £50,000 will apply.

If the money is held in a provider’s client account with a Bank, the FSCS protection comes into play. However, there is some legal uncertainty as to whether the £50,000 limit applies to the whole account or to each individual. If this situation applies to you, you had best ask your provider in writing to clarify the position in writing.

Finally, there will be situations where the deposit is held in an account with the provider. In this situation the FSCS protection will also apply, provided the PPP provider is authorised by the FSA which it ought to be (you must check if you are unsure about this). There are 2 uncertainties about this situation. It is possible that this will be treated as an investment rather than a deposit and so the £48,000 limit will apply. Also the legal status of the account could result in a situation where the appropriate limit will apply to the account as a whole rather than to each individual within the account. Given the uncertainties involved you must clarify the situation which applies to you with your provider.

We strongly advise that all queries of this nature be made in writing. We ourselves have found that making such enquiries by telephone can result in inconsistent, confusing and inaccurate advice.

Annuities

If the provider of your annuity were to go bust, you will qualify for compensation from the FSCS on the basis of the annuity being Long Term Assurance. The level of protection is unlimited and is calculated as 100% of the first £2,000 plus 90% of the remainder of the claim. The claim would be based on the value of the annuity and should include the level of spouse’s benefits, inflation cover and other features that you have built into the annuity.[18]

[18] TPAS website, ‘Security of Pensions’

4. Funding & compensation statistics

The FSCS's funding regime relies on a common interest among authorised firms in maintaining the reputation of the sector in order to attract future business. It is questionable whether this motivating factor would exist at occupational pension schemes which are voluntary arrangements and which are more focused on meeting past promises. Since funds do not compete for business it is possible that the risk of moral hazard is higher than at investment schemes. The possible cost of a guarantee fund for pensions is also an issue. If you compare the most similar part of the FSCS, the insurance sub-group, for long term liabilities it pays 90 per cent of the policy value. However, this is usually 90 per cent of the guaranteed policy value (with no credit for discretionary or terminal bonuses) so is usually significantly less than the policyholder might have otherwise expected to receive. It is possible that to make a pension guarantee scheme affordable, similar restrictions would be needed, but that then creates a scheme which still leaves pensioners in a position of hardship.

It is clear that the crisis that hit the FSCS, was not something that its architects ever envisaged. The sheer scale of payments required overwhelmed its resources and payments could only be made because of loans from the Treasury. It will be recalled from above that the FSCS does not have substantial own resources, but relies on annual levies that it hopes will meet its expected outgoings. The FSA had to respond to the new situation and instituted a review of how levies would be increased and who would be asked to contribute to them.

According to a note from the FSA in December 2008 the FSCS contributed £14 billion in regards to B&B; and £4.4 billion with respect to the various Icelandic banks; and £273 million for London & Scottish.[19]

This caused something of a revolt by some of the participants. Building societies in particular were angry that their very small resources (in comparisons to banks') would be committed to make good the excesses of their riskier competitors. The Nationwide Building Society has been one of the more vocal opponents of the new levies. A press release of February 2010 outlined their position:

> What is the cost of the levy?
>
> The Treasury Select Committee summed up the inequities of the levy in their Banking Crisis report, published in April 2009: "It is entirely inappropriate that institutions that are recognised as having a safer funding model, indeed have such a funding model enshrined in legislation in order to protect their depositors, should be required to contribute more to the industry's insurance scheme than competitors with funding models that have failed in the current crisis".
>
> Building societies have been disproportionately hit by the failure of Bradford and Bingley, Kaupthing Singer and Friedlander,

[19] Letter from Thomas Huertas 31 December 2008

> Icesave, Heritable Bank and London Scottish bank. The sector's share of the FSCS bill will be up to £200 million per year for the next three years to pay for the interest on the loans made by the Government to the FSCS following these failures. For 2009-10 it will be around £100 million, equivalent to about 7.5 per cent of the sector’s pre-tax profit for 2008-09 financial year ends.
>
> After September 2011, the principal of the loans will become due. The amount outstanding is uncertain, but could be higher than £200 million per annum for Societies. For Nationwide, reported profit to April 2009 was 53% lower than it would otherwise have been because of the levies payable to the FSCS.
>
> Why is it unfair?
>
> On announcing Nationwide’s 2008-09 annual results, CEO Graham Beale highlighted the underlying problem:
>
> “We regard the fact that the FSCS charge is not linked to the level of risk posed to the financial system by individual institutions, but instead is allocated by share of the retail savings market, as illogical and unfair, producing a disproportionate outcome for the low risk retail funded institutions, particularly building societies”. In other words, institutions that fund themselves prudently through retail funds pay the most contribution, a situation that the Treasury Select Committee described as “absurd” and which consequently places a burden on our members, who ultimately pay for this. Institutions relying excessively on wholesale funding from the market, a main factor in the financial crisis, pay less than building societies who are required by law to raise at least 50% of their funding through members and in practice raise on average 70%.[20]

The sums being raised were substantial. In February 2009, the FSA estimated that the forecast default cost was £435 million for 2008/9 and £645.4 million in 2009/10.

Even after the first round of failures the FSA was forced to publish (14 November 2007), plans for a complete overhaul of the way in which the FSCS was funded. The relevant FSA release is reproduced below:

> FSA/PN/115/2007
>
> 14 November 2007
>
> The Financial Services Authority (FSA) today confirmed the future funding arrangements for the Financial Services Compensation Scheme (FSCS) which will operate from 1 April 2008.
>
> The new funding system will:
>
> considerably increase the funding available to pay valid claims to consumers;
>
> be more robust and sustainable than the present arrangements;
>
> promote greater consumer protection and help maintain market confidence through financial stability;
>
> apportion the cost of compensation between regulated firms as fairly as possible; and
>
> be simpler to administer.
>
> **New funding model**

[20] Nationwide Building Society: February 2010,

> The new funding model relates to retail business and:
>
> introduces a 'widening circle' of funding under which compensation costs emerging from a particular sub-class of firms is borne by that sub-class alone, up to its annual threshold, after which higher costs are shared more widely; and
>
> expands the overall financial capacity of the scheme - up to a maximum of £4.03 billion per year.
>
> The scheme is divided into five broad classes (life and pensions; investments; general insurance; deposits; and home finance). Each class, except deposits, will have two sub-classes and above these broad classes would be a general retail pool. The initial tranche of costs will fall to the relevant sub-class, the next to the relevant broad class and then finally above that to a general retail pool. This last level of funding is only expected to be triggered in the event of a significant default, or series of defaults.

To understand the new system it is simplest level to think of there being a fund of money available for payments for each of the sub classes of business – e.g. insurance. In March each year, the FSCS estimates what the size of each of these funds should be and makes levies on the individual groups, or sub groups to meet any deficiency. If the fund is in surplus, repayments are made. The fund estimates for 2008/09 are shown below:

Sub-class initial funding requirement estimates 2008/09:

£m	
A Deposit	5.0
B1 General Insurance - provision	73.8
B2 General Insurance - intermediation	2.0
C1 Life & pensions - provision	1.0
C2 Life & pensions - intermediation	32.0
D1 Investments - fund management	7.0
D2 Investments - intermediation	9.0
E1 Home finance - provision	0.0
E2 Home finance - intermediation	1.0
Total	130.8
Existing fund balances	100.1
Net new money	30.7

Source: FSCS Plan & Budget 2008/09

New levies were issued to raise the £30.7 million required to fill the deficit. It was these new levies, which fell on groups such as the building societies that caused the anger mentioned above.

It should be noted that the FSCS is a creditor of B&B, Landsbanki, Heritable, KS&F and London and Scottish banks. Money recovered from these organisations will reduce the amount needed from other institutions.

In November 2009 the FSA announced a further review of the regulatory fees and levies system.[21] The accompanying press release stated:

> Following a review of its approach for determining the annual fees that firms pay, the FSA is consulting on a number of

[21] FSA website.

> measures to ensure that fees continue to be set in a fair way, and to make the basis for calculating fees easier for firms to understand, including:
>
> Setting a standard 'minimum fee' that all firms will have to pay to cover the basic cost of being regulated;
>
> Ensuring that 'variable' fees over and above this basic minimum amount increase in direct relation to a firm's size – with the result that fees for the largest firms reflect the greater regulatory engagement they receive.
>
> By the end of November, the FSA will publish a Fees Calculator which will enable firms to assess what these proposals mean for them.
>
> Mark Norris, the FSA's chief operating officer, said:
>
> "We are committed to delivering fair and transparent fees to all authorised firms. This is particularly important given that we are funded entirely by the firms we regulate, so we need to ensure firms can clearly see how we calculate their contribution to the running costs of the FSA."
>
> The FSA is inviting responses to the proposals in its consultation paper by 11 January 2010. In February 2010, depending on the outcome of this consultation, the FSA plans to consult on fee levels for 2010/11 using this new fee model.

The outcome of the consultation has yet to be announced.

Compensation statistics and details can be found in the FSCS Annual Report (see below). Selected statistics are shown below:

FSCS involvement in major bank defaults

	Accounts		Notes
	N^{o} compensated	Value	
		£ millions	
Bradford & Bingley	3.6 million	14,000	Final value estimated at £15.75 billion
Kaupthing,	157,000	2,500	transfer of deposits
Singer & Friedland		166	paper based claims on behalf of HMT
Heritable	22,344	500	transfer of deposits
		8	paper based claims on behalf of HMT
Icesave	273,142	3,900	expected to rise by £600m
London Scottish	3,762	90	
Dunfermline BS	260,000	na	to be determined

Source: FSCS 2008/9 Annual Report

Other compensation statistics (for 2008/9) are shown below:

FSCS compensation payments

Class	£ millions
Deposit (exc major defaults)	0.54
General insurance provision	50.79
General insurance intermediation	0.13
Life & pensions intermediation	17.62
Investment fund managment	5.92
Investment intermediation	17.44
Home finance intermediation	0.30
Total	92.74
Major defaults	19,767.47
Total	19,860.21

Source: FSCS Annual Report

5. Further information

The FSCS produces a number of guides for consumers and industry. These are available from its website at: http://www.fscs.org.uk/industry/publications/

See also:

For details of how to make a claim against the FSCS.

Their latest Annual Report (2008-09).

Group	FSA authorised institution	FRN Brands covered by this authorisation
HSBC	HSBC Bank plc	HSBC First Direct
	HSBC Private Bank UK Ltd HFC Bank Ltd Marks & Spencer Financial Services plc	HSBC Private Bank UK Ltd HFC Bank Ltd Marks & Spencer Financial Services Plc
Barclays plc	HSBC Trust Company Barclays plc Barclays Bank Trust Company	HSBC Trust Company Barclays Bank plc Barclays Bank Trust Company
Royal Bank of Scotland plc	Royal Bank of Scotland plc	Royal Bank of Scotland plc Direct Line (savings only) Child & Co. Drummonds The One Account Lombard Holt's
	National Westminster Bank plc Coutts and Co Ulster Bank Ltd Adam & Company plc	National Westminster Bank plc Coutts and Co Ulster Bank Ltd Adam & Company plc
Tesco Personal Finance Ltd	Tesco Personal Finance Ltd	Tesco Personal Finance Ltd
Lloyds Banking Group plc	Lloyds TSB Bank plc	Lloyds TSB Bank plc Cheltenham & Gloucester Savings
	Scottish Widows Bank plc Lloyds TSB Scotland plc AMC Bank Ltd Lloyds TSB Private Banking Ltd	Scottish Widows Bank plc Lloyds TSB Scotland plc AMC Bank Ltd Lloyds TSB Private Banking Ltd
	Bank of Scotland Plc	Bank of Scotland Bank of Scotland Private Banking Halifax Birmingham Midshires St James's Place Bank Saga Intelligent Finance Capital Bank
	Sainsbury's Bank plc	Sainsbury's Bank
Abbey National plc	Abbey National plc	Cahoot Bradford & Bingley Abbey National plc ASDA
	Cater Allen Ltd Abbey National Treasury Services plc	Cater Allen Ltd Abbey National Treasury Services plc
	Alliance & Leicester plc	Alliance & Leicester plc Alliance & Leicester Commercial Bank Moneyback Honeycomb
National Australia Group ltd	Clydesdale Bank plc	Clydesdale Bank Yorkshire Bank
AIB group (UK) plc	AIB Group (UK) plc	Allied Irish Banks plc AIB (GB) First Trust
The Co-Operative Bank plc	Co-Operative Bank plc	Co-Operative Bank Smile
	Unity Trust Bank plc	Unity Trust Bank plc
Standard Life Bank	Standard Life Bank plc	Standard Life Bank plc
Northern Rock plc	Northern Rock plc	Northern Rock plc
Britannia Building society	Britannia Building Society	Britannia
Zurich Bank	Dunbar Bank plc	Dunbar Bank plc
Nationwide Building Society	Nationwide Building Society	Nationwide Building Society Derbyshire Building Society* Cheshire Building Society* Dunfermline Building Society**
Skipton Building Society	Skipton Building Society	Skipton Building Society Scarborough Building Society*
Yorkshire Building Society	Yorkshire Building Society	Yorkshire Building Society Barnsley Building Society*

Note:

* Customers who had money deposited with these societies before the mergers are entitled to the same level of coverage after the merger. So, for example, if a customer had accounts at Nationwide and Cheshire Building Societies, between their accounts customers will have a total potential coverage of up to £100,000 (up to £50,000 coverage for each society they banked with). Please note that the FSCS does not apply in relation to deposits placed with the Cheshire's Isle of Man branch.

** Customers who had money deposited with these societies before the transfer of accounts under the Banking Act 2009 are entitled to the same level of coverage as before the transfer. So, for example, if a customer had accounts with both Nationwide

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