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Dear Graeme

### **Financial Services Compensation Scheme Funding Review**

This is the Financial Services Consumer Panel's response to Discussion Paper 06/1, the FSCS Funding Review. The Panel is grateful to have had the opportunity to participate in the FSA's Industry Advisory Group in advance of the publication of this Paper.

#### **Overview**

The Panel believes that, together with the Ombudsman Service, the Compensation Scheme plays a vital role in protecting consumers of financial services in the last resort. It is in the interests of consumers that

- The cost of the Scheme is spread amongst firms in a proportionate way – much of the burden will ultimately be met by consumers;
- The Scheme is easily accessible to consumers;
- Claims on the Scheme are dealt with swiftly and fairly; and
- The Scheme is sustainable.

With one important exception – the question of possible future increases in compensation limits - we do not generally take issue with the assumptions set out in paragraph 3.3 of the Paper and overall we are quite happy with the design principles set out in paragraph 3.10. Nor do we disagree with the FSA's preferred option B, which importantly provides for a general pool that should ensure that consumers could be fully compensated.

Answers to the specific questions posed in the Paper are set out below.

*Q1: do you agree with the analysis in this section [section 2]?*

Yes, we believe that this section presents an accurate analysis.

*Q2: do you have any other concerns about the current funding arrangements generally?*

No.

*Q3: do you agree with our assumptions [paragraph 3.3]?*

With one exception – that the limits governing payment of compensation to individual claimants will not be set at higher levels. In the Panel's response to the recent Review of the Compensation and Ombudsman Service Limits we pressed strongly for an increase in limits and in some cases, the abandonment of limits altogether. Although the FSA has decided that there will be no increases at the moment we will continue to lobby for this and future increases cannot be ruled out. It is essential that whatever funding structure is put in place, it must be flexible enough to accommodate increases in limits.

*Q4: do you have any comments on our analysis of the legal constraints [paragraphs 3.4-3.7]?*

We have no comments.

*Q5: do you have any comments on these design principles [paragraphs 3.10-3.11]?*

We are generally happy with the design principles. Affordability is we believe a key issue. We would not wish small firms of good standing to be put out of business on account of the levy generated by the default of similar, but less well-managed firms.

*Q6: do you have any suggestions about how to work out practicability thresholds?*

No.

*Q7: Should mortgage lenders become potential contributors to the FSCS, through membership of the mortgage class?*

Yes.

*Q8: if so, should the FSCS also cover their liabilities to consumers?*

Yes.

*Q9: should there be one 'super class' or two separate classes for (i) life and pensions and (ii) securities, mutual funds and derivatives?*

Two classes are needed. Mutual funds should not be expected to bear any disadvantage by being linked in with life and pension problems, even though there

may be a business overlap at the top in terms of control and ownership, since this does not extend to a similar overlap at the consumer end of things.

*Q10: which [of the three options] do you prefer and why?*

We agree that option B is the most sensible option of the three. It would be more robust than the present arrangements. By putting in one class of firms with mutual financial interest, it avoids IFAs comprising a single class.

*Q11: If there is a general pool, should there be a ceiling on firms' liability to contribute to it?*

*Q12: if there is no general pool, should there be ceilings at class level?*

*Q13: what are the implications of ceilings in relation to consumer protection and market confidence?*

We see no rationale for a limit to be imposed, and a ceiling would be likely to reduce consumer protection and confidence in the market.

*Q14: Do you agree that this [paragraphs 5.1-5.3] is the right way to assess arguments for special treatment?*

*Q15: what should the special cases be, and why?*

*Q16: should wholesale firms become liable to make a contribution to compensation costs?*

*Q17: would that liability be only at the level of the general pool, or within a broad class as well? Which class?*

*Q18: does the case of direct sellers merit special treatment?*

*Q19: if so, what form should it take?*

We have no comment on questions 14 to 19.

*Q20: do you have any comments on our analysis of the legal constraints on pre-funding [paragraphs 6.1-6.3]?*

We do not wish to raise any issues in relation to the analysis.

*Q21: do you agree that pre-funding is not a workable option for funding the FSCS?*

We agree.

*Q22: do you agree that the FSCS should be allowed to levy on the basis of a forward look of more than 12 months when it proves practicable to do so?*

Yes.

*Q23: do you agree that borrowing can have only a tactical role in FSCS funding, and should remain an operational matter for the FSCS?*

We agree.

*Q24: do you agree that insurance should remain an operational matter for the FSCS?*

We agree.

*Q25: do you agree with these assessment criteria [paragraph 7.5]?*

We agree with the assessment criteria. Fairness and proportionality are particularly important.

*Q26: are there others that should be added?*

We have no suggestions for additional criteria.

*Q27: is a universal tariff base viable; and, if so, what measure should be used?*

We have no comments on this question.

*Q28: do you have any class-specific measures to suggest?*

No.

*Q29: do you agree that option 3 is not satisfactory in the long run?*

We agree that this option seems to be too problematic to be workable in the long run.

*Q30: do you agree with this view of the way forward [paragraphs 7.12-7.13]?*

This seems a sensible approach.

*Q31: do you agree with these criteria [paragraphs 8.1-8.3]?*

Yes.

*Q32: do you have any suggestions about how the allocation might work?*

No.

*Q33: do you agree that levies after a specified date (probably 30 September 2007) should be governed by the new funding regime?*

Yes.

*Q34: do you see a need for any exceptions to this clean break?*

No.

## **Conclusion**

The responses to this Discussion Paper, together with the results of the Oxera work and input from the Industry Advisory Group, should enable the FSA to prepare an informed and practical series of proposals for formal consultation in the autumn. Care needs to be taken to ensure that the new funding structure is flexible enough to accommodate future changes to compensation limits.

We will continue to contribute to this important debate as the consultation process progresses.

Yours sincerely

A handwritten signature in black ink, appearing to be 'J. Howard', written in a cursive style.

John Howard  
Chairman  
Financial Services Consumer Panel