Financial Services Compensation Scheme

Annual Report and Accounts

2016/17

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FSCS contacts

This document can be found on our website at: www.fscs.org.uk

Enquiries should be addressed to:
The Financial Services Compensation Scheme
10th Floor
Beaufort House
15 St Botolph Street
London
EC3A 7QU

Or contact us online

Company number 3943048

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BUSINESS HIGHLIGHTS

The main figures and events of 2016/17

July 2016

Gibraltar-domiciled Enterprise Insurance Company PLC enters provisional liquidation.

April 2016

Our business continuity site outside London goes live, increasing our resilience to unexpected events.

August 2016

Final dividend of £26m from London Scottish Bank recovers 63.4p in £.

We successfully 'failure test' our IT infrastructure.

October 2016

We take part in a simulation of a crisis event and deposit failure.

We restore customers' satisfaction with FSCS to previous levels.

November 2016

Liechtenstein-domiciled Gable Insurance AG enters liquidation.

December 2016

We launch an online portal for direct customer applications.

Funding review consultation is issued by the Financial Conduct Authority.

February 2017

We adopt a new risk-management framework.

January 2017

Our deposit protection limit increases to £85,000.

We raise net supplementary levies of £64m, including a retail pool levy of £26m.

We issue our Plan and Budget for 2017/18.

March 2017

On 31 March 2017, HM Treasury announces the sale of the Bradford & Bingley mortgage book for £11.8bn, with repayment of £11bn to FSCS in April 2017.

01 CHAIRMAN'S STATEMENT

Lawrence Churchill reports on a review into FSCS funding and how we make our protection understandable to all consumers

> If a robust way of reflecting risk can be found, this will be fairer and create the right incentives for firms to act prudently.

Overview of the year

FSCS has steadily developed its capability since the financial crisis of 2008. The Chief Executive describes in his introduction how our investments in claims handling now give better service to our customers and lower unit costs to our levy payers. Our digital service, launched last December, marks an important stage in this work.

Stakeholders

Alongside this investment in our business, FSCS must also look outwards to our stakeholders and to consumers. The FSCS Board has always recognised that, although we are a statutory body, our success depends on our stakeholders' support. In return, we need to show them we carry out our responsibilities efficiently and transparently, and that our costs are reasonable and shared fairly across the industry.

The current Financial Conduct Authority (FCA) review of FSCS's funding looks at how to share compensation costs fairly. We strongly support the FCA's focus in its December consultation document on increasing the resilience of some firms, which could arise through making the professional indemnity (PI) market work effectively. Such increased resilience would make it more likely that FSCS would be able to recover far more of our compensation costs without raising levies.

Equally, we see the case for reflecting the risk that different firms pose to FSCS in the levies we raise. If a robust way of reflecting risk can be found, this will be fairer and create the right incentives for firms to act prudently. However, we agree that with so much diversity across financial services, striking the right balance is difficult.

To improve understanding of our finances, in addition to this Annual Report and Accounts, we are publishing for the first time a separate document showing the movements in 2016/17 across each of the FSCS classes. This is to help levy payers see how our forecasts of compensation costs and recoveries have turned out in practice and their impact across the year.

We have also continued to invest in our relationships with the regulators and with HM Treasury. FSCS does not have responsibilities to make regulations, but it is very important that we effectively support organisations that do.

By doing so, we can ensure that our expertise and capacity to compensate consumers align with policies for financial stability and consumer protection. Our regular contacts and joint exercises with the Prudential Regulation Authority (PRA), FCA and HM Treasury in 2016/17 are important in ensuring this alignment.

Consumer confidence

Firms support FSCS because they recognise that our safety net supports public confidence in financial services and underpins financial stability. We strive to keep our protection in line with market developments. We particularly aim to communicate the protection we provide to consumers in easy to understand and memorable ways. This is important especially for retirement savings where consumers now have more choices about investments that generate an income.

To simplify the protection message, we support harmonising the protection we offer for retirement savings. But we recognise this will only be acceptable to our levy payers if steps are also taken to ensure that FSCS genuinely is the last resort, not the first one, when things go wrong. We recognise that the costs and benefits of any harmonisation need to be carefully considered by the regulators.

Legacy of 2008

FSCS continues to work hard to maximise recoveries from the estates of failed firms and from third parties responsible for customers' losses. Since the 2008/09 banking crisis, we have recovered £4.5bn from the estates of the failed Icelandic banks, London Scottish Bank, Keydata Investment Services, MF Global and Alpari (UK) Limited.

In March, the Chancellor of the Exchequer authorised an £11.8bn sale of Bradford & Bingley (B&B) loans acquired by the taxpayer during the financial crisis. This is a major step in returning taxpayers' money after the 2008/09 crisis. As a Board, we have consistently sought to realise value from the stake FSCS acquired in the B&B estate in 2008, so we are delighted that £11bn of those proceeds will repay FSCS. This, in turn, enables us to reduce our borrowing from HM Treasury and reduce the interest payments we pass on to banks, building societies and credit unions. This is a good outcome for FSCS and its levy payers.

Governance, culture and the Board

During the year, the Board paid particular attention to monitoring the Scheme's operating performance and welcomed the rise in customer satisfaction as the new claims process we introduced in 2015 bedded in.

We continue to review our regulatory obligations and adopt many areas of best practice as set out in the UK Corporate Governance Code. During the year, we worked hard to enhance our risk and control framework to articulate more clearly our principal risks and mitigating controls.

David Weymouth resigned on 31 December 2016, with Liz Barclay and Jayne Nickalls also stepping down from the Board on 30 June 2017. The Board would like to thank them all for the fine contributions they have made, combining support and rigorous challenge in equal measure. Liz has been an outstanding Deputy Chair and Chair of the Remuneration and Human Resources Committee. David has chaired the Risk Committee and, in that capacity, greatly developed FSCS's risk and control culture. Jayne has contributed significantly to the launch of FSCS's digital service. We wish them all well for the future.

Employees

Our employees have worked hard to capitalise on our investments since 2008 in improving our service to customers. Our Legal and People teams received external recognition this year. I thank them all for their continuing contributions. In addition, we completed changes to the Executive Team and I am pleased to see that the team has bedded in and is operating effectively.

Reflections

As I enter my final year as Chair, I am pleased to report that FSCS has fulfilled so successfully its statutory duties as a compensation scheme. In particular, it has recovered £4.5bn from the estates of insolvent entities. However, the amounts of levies raised – at over £4.5bn – may lead to discussion about the frequency of failure of financial firms and the scope of protection.

Two issues stood out for me when I took up the role – that something should be done about the B&B loan, which is now on its way towards successful resolution and that the variety of rules about compensation levels outside of deposits made them very difficult for ordinary people to understand. We should all take the opportunity given by the FCA Funding Review to establish a regime that is not only sustainable, but is also easier to understand.

Lawrence Churchill
Chairman

4 July 2017

£11.8bn

In March, the Chancellor of the Exchequer authorised an £11.8bn sale of Bradford & Bingley loans acquired by the taxpayer during the financial crisis. This is a major step in returning taxpayers' money after the 2008/09 crisis.

02 CHIEF EXECUTIVE'S REVIEW

Mark Neale highlights FSCS's responsiveness to unpredictable failures in an ever-evolving industry

Our environment

FSCS's responsibility to protect consumers and to underpin financial stability depends on our ability to respond to financial failures whenever they occur. During the year, the industry has become more fluid and challenging, yet we have moved ahead with our strategy and dealt with several unforeseen failures.

The 2016/17 year has shown once again that our workload is volatile and unpredictable. The failures of Enterprise Insurance Company PLC (Enterprise) and Gable Insurance AG (Gable) were complicated because of the range of products sold and because of the complex network of brokers and sub-brokers who managed those sales. We have worked closely with the insolvency practitioners, overseas authorities, the PRA and the FCA to provide new cover for policyholders where we can and to return funds to customers quickly when that is not an option.

These failures – combined with increasing claims associated with Self-Invested Personal Pension plans (SIPPs) – meant we had to raise three supplementary levies totalling £114m during the year. A repayment of £50m in the Investment Intermediation class brought our total levy for the year to £738m.

Fulfilling our strategy

We continue to deliver our Vision for a Confident Future by investing in our claims-handling process.

We have been able to pay the great majority of savers in failed banks, building societies or credit unions within seven days since January 2011. We resolved three credit union failures in this way in 2016/17.

We outsource the handling of the great majority of our non-deposit claims, so transferring the 'volume risk' to bigger organisations better placed to manage it.

After introducing a common claims-handling platform and common processes with our outsource partners in May 2015, we experienced initial difficulty bedding in our new processes for handling non-deposit claims. So in the first quarter of 2016/17, a Scheme priority was to tackle the resulting deterioration of service and fall-off in customer satisfaction. We did so, and at the same time we continued to develop our service so that it meets the expectations of our customers, who often come to us in distress and are entitled to a professional and sympathetic service that helps to restore their trust in the industry.

A significant improvement was launching our online claims service in December, which lays the foundation for our digital service. This service enables customers to submit and track claims online. It is already working well, with around 30 per cent of our customers who contact us directly now making claims this way.

We continue to focus on our readiness to respond to failures as they occur. To support our own contingency planning we opened a new disaster-recovery site at the Bank of England facility outside London during the year.

"

During the year, the industry has become more fluid and challenging, yet we have moved ahead with our strategy and dealt with several unforeseen failures.

> In the last quarter of 2016/17, we turned around 95 per cent of claims within our service level (target 90 per cent).

EU Referendum

Following the triggering of Article 50, while the UK remains in the EU, the UK financial system will continue to be regulated in accordance with its existing obligations as an EU Member State.

Our performance

A total compensation cost of £375m was not out of the ordinary for recent years. But we nevertheless faced both new and growing demands. We protected UK policyholders affected by the failure of Enterprise and Gable at a cost so far of £50m. We also compensated 3,565 customers who had been wrongly advised to shift their retirement savings from occupational schemes into risky assets held within SIPPs. The cost of these SIPP-related claims in 2016/17 was £105m.

Investing in our new claims-handling process has improved our service. As a result:

- customer satisfaction is back at 76 per cent – we have set a target of exceeding 80 per cent by March 2018;
- the online claims service has enabled us to redeploy a rising number of claims smoothly among our outsource partners and, accordingly, to meet our service levels. In the last quarter of 2016/17, we turned around 95 per cent of claims within our service level (target 90 per cent);
- our process was better controlled, with paper largely eliminated and access rights and separation of functions automated; and
- like-for-like claims-handling costs fell by around 14 per cent compared with those before May 2015.

In summary, a primarily outsourced business model supported by the new shared claims-handling platform and online claims service has enabled us to improve our customer service and value for money.

Outlook

We'll continue to build on these foundations, in particular by promoting take-up of our digital service and opening it to customers' representatives, such as claims management companies. In the year ahead, we'll also aim to refresh our outsourcing strategy by reviewing the number of partners and seeking to let longer, larger contracts that provide better incentives for investment and partnership working.

It is, of course, conventional to state that our progress in the last year is down to the people working at FSCS, but it is no less true for that. Progress has not always been smooth and there have been setbacks, but the professionalism and commitment of our people has not wavered.

Mark Neale
Chief Executive

4 July 2017

Following the triggering of Article 50, while the UK remains in the EU, the UK financial system will continue to be regulated in accordance with its existing obligations as an EU Member State.

STRATEGIC & PERFORMANCE REPORT
03 OVERVIEW

Understanding FSCS's role, mission and strategy

The Strategic & Performance Report reviews the Scheme's mission, our role and strategy, together with our performance during 2016/17 and future outlook.

Our role

The Financial Services Compensation Scheme (FSCS) is a non-profit-making independent body created under the Financial Services and Markets Act 2000 (FSMA). We are the UK's statutory fund of last resort for customers of authorised financial services firms. This means we can provide compensation if an authorised financial services firm is unable, or is likely to be unable, to meet claims against it.

FSCS is the manager of a single scheme under FSMA and assesses and pays compensation to our customers in accordance with the scheme rules. These rules are set by the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA). We protect deposits, insurance policies, insurance broking (for business executed on or after 14 January 2005), investment business, and home finance advice and arranging (for business executed on or after 31 October 2004). The rules say how FSCS raises funds to meet its costs, namely by levies raised on the industry. Where necessary, FSCS can also borrow funds commercially or from HM Treasury. Our service is free to consumers.

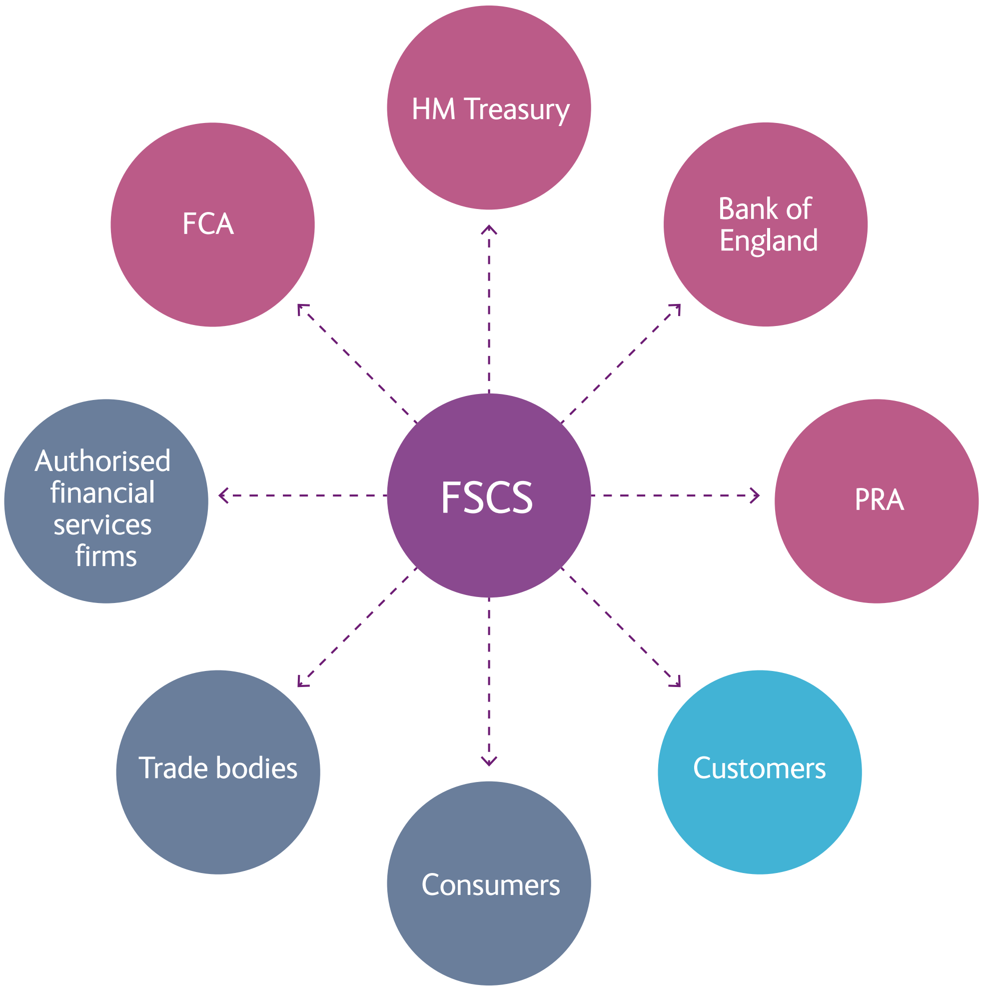
We are a private company limited by guarantee and governed by a board of directors, whose terms of appointment require them to operate independently of the FCA and PRA. Further details of how we are governed are in Section 8.

We work in the regulatory sector to promote public confidence and consumer protection in UK financial services.

HM Treasury is responsible for the overall institutional structure of financial regulation and the legislation that governs it, including the negotiation and implementation of EU directives. We work closely with the FCA and the PRA which regulate the firms that provide financial services and products to consumers.

FSCS is operationally independent, but accountable to the FCA and the PRA, and to HM Treasury. Under FSMA, the FCA and the PRA do what is necessary to ensure that at all times FSCS can exercise its required functions. FSCS works very closely with all regulatory authorities to ensure we can respond effectively to any failures. We evaluate future risks and have developed detailed contingency plans to ensure we are prepared for a variety of events.

Relationship with our stakeholders



On 30 January 2017, FSCS protection for deposits in banks, building societies and credit unions increased from £75,000 to £85,000. Joint accounts will also benefit from the increase, with a combined limit of £170,000. This increase complies with the Deposit Guarantee Schemes Directive (DGSD), which requires an adjustment following such events as fluctuation in the sterling/euro exchange rate. We reflected this change in our public awareness and industry disclosure materials.

By law, FSCS must pursue recoveries that are "reasonably possible and cost-effective". During the year, we updated our recoveries policy which can be found here: www.fscs.org.uk/industry/funding/recoveries/.

We continue to pursue funds from various sources. We make many recoveries through claims on the estates of failed firms as part of the insolvency process. We recover funds from claims against professional indemnity insurers where we have paid compensation after the policyholder firm has failed. We may also seek recoveries against other third parties where we can establish that they contributed to customers' losses.

We tailor our recoveries approach to the nature of the assets and their location, seeking to maximise recoveries cost-effectively, and instructing external expertise as appropriate.

Our mission and strategy

Our mission is to provide a trusted compensation service for customers that raises public confidence in the financial services industry.

Our strategy is to achieve the seven imperatives outlined in our Vision for a Confident Future by 2019, by focusing on our strategic priorities each year.

Our strategic imperatives

During the year, we reviewed our progress against our 2014 five-year plan in order to refocus our strategic priorities for 2017/18 and beyond.

Serving our customers

- Improved customer satisfaction to 76%, exceeding target of 70%
- Introduced a new online claims service for customers who contact us direct
- Developed more constructive working relationships with our partners
- Responded effectively to unforeseen Enterprise and Gable general insurance failures

Diversifying our compensation routes

- Increased the number of investment and life and pension intermediation claims paid by electronic bank transfer
- Commenced an evaluation of alternative payment options, in particular for deposits
- In December, an FCA consultation paper raised specific issues on investment and retirement savings protection. As a result, possible options being considered include an increase to the investment-business limit and changes to the class structure

Deepening contingency planning

- Set up a new disaster-recovery site outside London
- Tested business resilience plans including:
  - recovery from major IT failure across our end-to-end process, including our outsource partners
  - crisis management to assess our ability to continue operations after disruptive events
- Carried out a simulation exercise of a deposit failure with the authorities to understand the shared responsibilities in the event of a crisis

Improving our value for money

- Improved our ability to respond to increased claims numbers and reduced the cost of processing outsourced claims (by building our own new claims-handling platform)
- Reduced our reliance on contracting resources
- Introduced activity-based budgeting to better explain the link between the costs we incur and the results we deliver

Raising awareness of the protection that we provide

- Consumer awareness of FSCS at 78%
- Worked with the industry to introduce the new limit of £85,000 for deposit protection (producing new in-branch materials for banks, building societies and credit unions)
- Featured in nearly 4,811 stories in the broadcast and printed media, about 8,100 posts on social media and reached 83% of all adults an average of 79 times with FSCS messages across an even spread of all social demographics
- Developed with the industry a potential voluntary agreement for the use of 'FSCS Protected' badge in bank and building society communications
- Launched our *Money Means* newsletter (with 4,000 subscribers)
- Ran a contact and briefing programme to inform MPs about FSCS, with 81% agreeing FSCS is vital to ensuring public confidence in financial services

Achieving excellence as a creditor

- Bradford & Bingley: on 31 March 2017, HM Treasury announced the sale of buy-to-let loans for a total of £11.8bn; this has generated a repayment of £11bn to FSCS
- Dunfermline: £500m of interim payments made by FSCS to contribute towards the cost of resolution to date; a residual amount of about £41.3m is expected to be paid from funds in hand once the administration is finalised, potentially in 2017/18
- Realised recoveries totalling £68m, including £28m from London Scottish Bank and £15m from Kaupthing Singer & Friedlander Limited
- Achieved significant recoveries of compensation costs paid due to Payment Protection Insurance mis-selling from certain lenders

Engaging our people

- Designed and implemented an executive development programme
- Launched a new HR self-service information system for all employee requests and an online benefits system

Serving our customers – the strategic review

We continue to modernise our compensation service for customers and enhance our ability to deal with major failures. We have adopted an outsourced operating model to improve our ability to manage an unpredictable and volatile volume and mix of claims. This decision was implemented in 2015 after in-depth analysis showed that outsourcing remained the best value option for FSCS. We currently outsource processing of approximately 95 per cent of claims to several partners under a Procurement Framework established in 2014.

The efficiency and control of our outsourced claims-handling process has been improved following the introduction in 2015 of a common claims-handling platform. This enables us to move claims rapidly between outsource partners in response to changes in demand and to eliminate paper flows.

The launch of an online claims-handling service in December 2016 has benefited customers by enabling them to provide the information and supporting evidence we need to assess claims earlier in the process.

After carrying out research into our customers' needs, we recognised we had to further develop our digital service if we were going to achieve our Vision for a Confident Future by 2019.

In 2016, a strategic review assessed what we needed to change and how best to do so. This gave rise to our 'Blueprint', the model of our future operation, which:

- is led by our customers' expectations;
- builds on our capability – in people, processes and technology;
- continues to use our investment in a common claims-handling platform;
- focuses investment on our core mission to serve customers and give value for money;
- provides a platform sufficiently agile to respond to changes among customers and the industry; and
- lays the foundation for our digital future over the coming years.

We have targeted the Blueprint's benefits in three areas:

- Improved customer service and satisfaction – by building on our online service through faster processes.
- Value for money for levy payers – by introducing agile processes, improved commercial partnerships and data analytics to monitor and drive performance.
- Better capability – to sustain people, processes and technology to ensure we can respond to market failures.

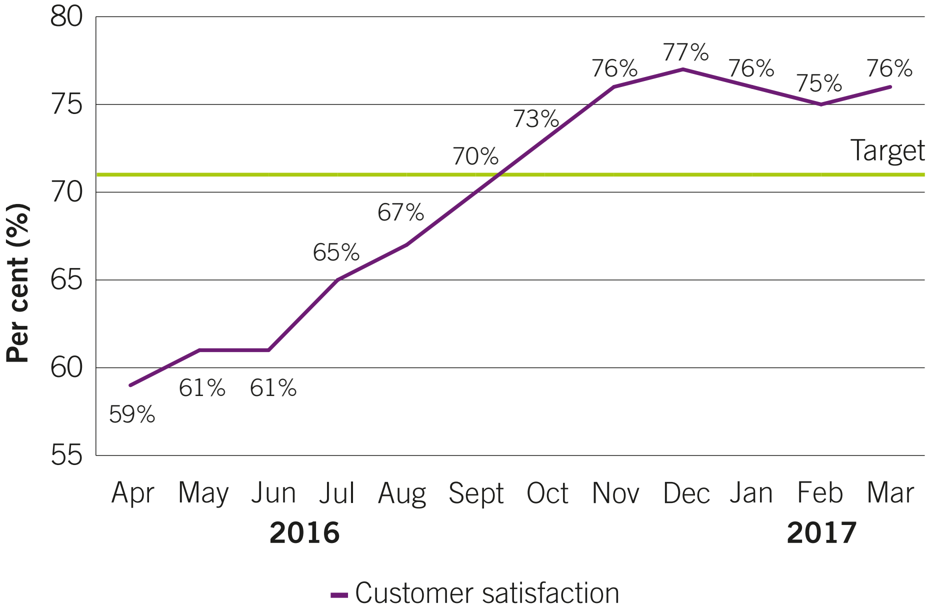
Investing and building for the future

To support our digital transformation and more agile ways of working, we now implement business change in quarterly releases. We have focused on restoring service, with investment prioritised across the following themes:

- **Transforming**: projects that radically change the business model (eg, the online claims service). These are initiatives that the Scheme will deliver to respond to our customers' needs, use new technology, drive improved value for money and enable the Scheme to achieve its Vision.
- **Improving**: projects that increase efficiency and our ability to respond to pressures such as an increased volume of work while maintaining service levels. Opportunities for better processes can range from improving the quality of what we do to reducing turnaround time and streamlining or automating manual activities.
- **Sustaining**: projects that are critical to maintain our current operations (eg, IT upgrades). These are 'must have' expenditures, typically the largest part of our change budget. Without them, our core business operations are put at risk.

We are developing strategic options to inform our Vision beyond 2019. This will support consumer confidence in the industry, serve our customers better, focus on value for money for our levy payers and

Customer satisfaction



allow us to create an attractive place to work, with effective mutual relationships with our stakeholders.

Regulatory landscape

The financial regulation landscape continues to change as new products are developed and regulated. We work closely with our colleagues at the FCA, the PRA and HM Treasury to monitor these developments and our own experience. FSCS provides analysis of claims data and lessons learned from specific firm failures to assist the authorities. We are also pleased to work with industry and consumer bodies such as the statutory panels and trade associations.

With the growth in new products, such as crowdfunding, and the extension of regulation to consumer credit, the scope of our protection is under review.

The FCA consultation paper CP16/42, *Reviewing the Funding of the Financial Services Compensation Scheme (FSCS)*, was published on 14 December 2016. As well as funding options, it raised extending FSCS protection by expanding coverage for some aspects of fund management and introducing protection for debt-management and structured-deposit intermediation. The paper also sought views on possible changes to compensation limits in light of pension freedoms.

As part of our international role, FSCS continues to work with international protection schemes through membership of the International Association of Deposit Insurers (IADI), the European Forum of Deposit Insurers (EFDI) and the International Forum of Insurance Guarantee Schemes (IFIGS). As a member of the EFDI, FSCS has been working with our European Economic Area (EEA) counterparts on the arrangements for cross-border depositor payouts, as required by DGSD. To support this work, FSCS is a signatory to the EFDI Deposit Guarantee Scheme Cooperation Agreement, which is supported by the European Banking Authority (EBA). The DGSD also laid down requirements for stress testing and peer reviews and FSCS is taking forward this work alongside our colleagues in Europe and from UK Authorities and counterparts.

This work continues following the EU referendum and the triggering of Article 50.

STRATEGIC & PERFORMANCE REPORT
04 DELIVERING FOR OUR CUSTOMERS

We report on how we are delivering our top priority of modernising our service to customers against a changing claims environment

Serving our customers – the customer journey
As part of our strategic review, we defined the customer experience we aspire to deliver. The journey stages are as follows.

Our customer journey

Discovering FSCS

“I’ve just found out that the firm I dealt with has gone bust. I’m worried my money could be lost. What can I do?

Making first contact

“I’ve found FSCS and they might be able to get my money back

“I’m reassured as I’ve got a potential claim and I know what I need to do

“I understand the reason why I may not have a potential claim

Completing the application

“I can submit my claim online with all the supporting information

“Help is available when I need it

“Although it takes some time to complete the application, I understand why the effort is necessary

Investigating the claim

“FSCS tell me within a few days if they have everything they need or if I have to provide more information

“They give me an idea how long it will take and tell me if this changes

“I can track progress online

Getting the decision

“I get the decision within the timescale I was promised

“I receive the payment within a few days

“I didn’t get the decision I was hoping for but I understand the reason why

Dealing with any issues

“I know what to do and who to contact if I’m unhappy, have questions or want to appeal

“They deal with me with empathy and fairness

Staying engaged

“I trust FSCS because they were efficient, helpful and fair

“If anyone I know has a potential claim I’ll reassure them about FSCS

Protected

Discovering FSCS – building consumer confidence and trust

Building awareness of FSCS protection boosts consumers' confidence and reassures them, as well as supporting financial stability. We have continued to focus on raising awareness of the £85,000 protection limit, for deposits, with many deposit takers promoting our badge as part of their own marketing material. Working in partnership with the industry is part of our long-term strategy. We are developing a voluntary framework for all deposit takers to adopt our badge, which will sustain the public's future awareness of our protection. We have encouraged the insurance industry to be more explicit with eligible policyholders about the protection FSCS offers.

Awareness of FSCS or a protection scheme for deposits is now 78 per cent among UK adults, the highest it has been, and an increase from 60 per cent in 2013/14.

Seventy per cent of those who know a little about the Scheme say it's reassuring and they trust us to compensate people.

Our research shows that the more aware people are of FSCS, the more confident they are about buying financial products. Seventy-five per cent are confident their money in banks and building societies is safe because they know about the Scheme and 63 per cent say they trust banks and building societies because they know FSCS protects them in the event of failure (Populus).

Our broad programme of activities includes marketing, public and parliamentary relations and working with industry, each strand supporting the other to raise awareness. We use social media, such as Facebook and Twitter, to share information about what we do and publish an electronic newsletter, *Money Means*, to underscore these messages.

The effectiveness of the Scheme's communications is evaluated using independent research. Its findings were shared with our Board, and fed back for information and guidance to our Advisory Panel and the authorities, whose input is highly valued.

Our website, www.fscs.org.uk, helps customers work through what protection they have and how to make a claim.

Making first contact

We have a dedicated support network for customers to contact us by telephone, email or letter. When we launched our online claims service in December, we extended our opening hours to support customers during the evenings and at weekends.

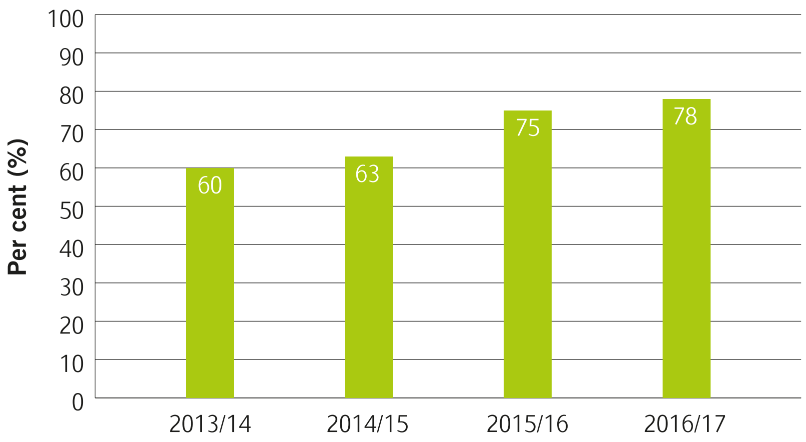
Over the past year, call volumes have fallen, although peaks in calls and enquiries occurred during specific events, such as the Enterprise Insurance Company PLC (Enterprise) failure.

Call abandonment peaked in August following the failures of Enterprise and two credit unions. Thereafter, call abandonment was within our target of 5 per cent.

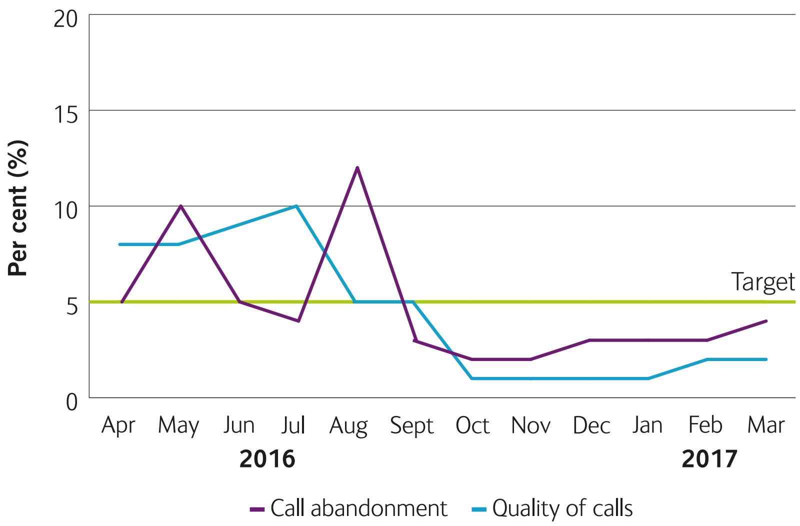
Completing the application

We introduced our new online claims service to provide an alternative to paper application forms for customers. This facilitates the uploading of relevant information

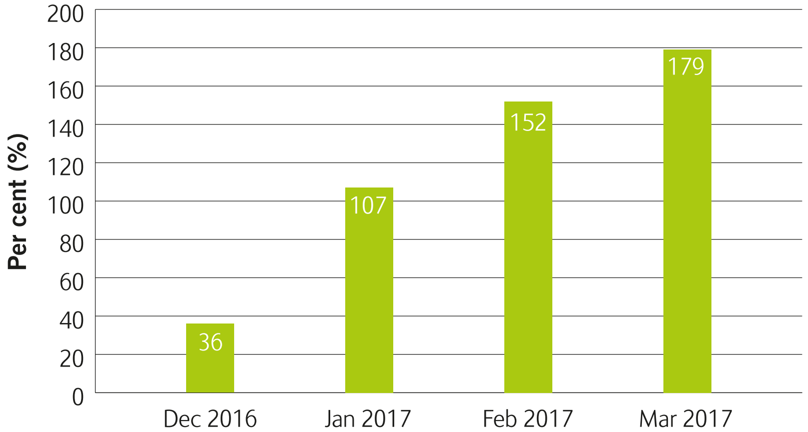
Awareness level



Call abandonment and quality



Online applications



and documents so that we can check whether we have everything we need to process a claim more quickly.

Investigating the claim

When a firm is declared in default, we review claims under our rules to assess eligibility. When dealing with claims, we identify any potentially vulnerable customers, such as people on benefits for whom we may make special arrangements to maintain their access to money.

Getting the decision

During the year, total compensation payments made were £351m, up from £271m in 2015/16. Compensation costs of £375m include an estimate for £24m for claims not yet paid.

This rise in compensation payments largely reflected a big increase in general insurance claims resulting from the failures of Enterprise and Gable Insurance AG (Gable). These claims, including entitlement to a return of premium, leapt to nearly 740,000, up from just under 14,000 in 2015/16, with nearly 160,000 of these claims paid in the year. Discussions are continuing with insolvency practitioners (IPs) and brokers about replacing the cover provided by Enterprise and Gable.

General insurance apart, FSCS received just under 29,000 claims in 2016/17, up from just under 33,000 in 2015/16. We received 16,801 claims directly from customers and 11,940 from representatives. We have seen an increasing number of complex Self-Invested Personal Pension (SIPP) related claims during the year. By working more effectively with our outsource partners, we have

Customer complaints

	2016/17	2015/16
About the claim decision	1,281	927
About the handling of the claim	373	308
Total complaints	**1,654**	**1,235**

successfully dealt with the teething problems encountered following the introduction of our single claims platform. This has contributed to a reduction in overdue claims and our ability to turn around claims more quickly. Across the year as a whole, we turned around 86 per cent of claims within target; by the end of the year that figure had reached 96 per cent. See table on page 29: Claims decisions and average payments by class.

Dealing with any issues

When a complaint about a decision is received, it is acknowledged within two working days. A Complaints Officer will carry out a review of the decision, taking into account any concerns raised and any additional evidence in support of the claim. The outcome of this review is final and there is no further appeal.

If the complaint is about the way we handled a claim, or about the service we provided, a Complaints Officer will investigate and resolve the complaint. The complainant may ask for their concerns to be referred to the Independent Investigator and we will make a referral if the complaint cannot be resolved. We may request any additional information necessary to refer the complaint for independent review.

The Independent Investigator will carry out a review of the handling of a claim or the service we have provided. The Independent Investigator will prepare a report which is considered by our Board of Directors and sent to the complainant. The annual report of the Independent Investigator may be found on page 33.

During the year, we responded to 1,654 complaints as compared with 1,235 last year. The increase (34 per cent) is attributable to the volume of claims received in the year. Nevertheless, we were able to resolve 93 per cent of these complaints within 20 working days.

Complaints about handling of the claims also increased on last year; but they are less than 0.05 per cent of total claims made during the year.

Twenty-three per cent of complaints received concerned the handling of claims. Many of these were about delays in making a decision or administrative errors, with the majority of the complaints in relation to the failure of Enterprise and Gable. We expect that the improvements made during the past year will help reduce the number of complaints we receive in the future.

Claims, decisions and average payments by class

	New claims		Decisions upheld		Uphold rate[1]		Average paid	
	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16
Deposits (SA01)	8,697	4,785	7,802	4,530	100%	100%	£218	£2,305
General Insurance Intermediation (SB02)	7,815	7,456	5,526	5,702	79%	75%	£1,882	£2,548
Life and Pensions Provision (SC01)	0	1	0	1	0%	0%	£0	£0
Life and Pensions Intermediation (SC02)	5,118	3,948	3,547	4,294	64%	60%	£29,518	£34,254
Investment Provision (SD01)	163	159	254	63	82%	63%	£34,646	£33,575
Investment Intermediation (SD02)	6,325	16,256	6,804	16,912	75%	90%	£11,787	£6,833
Home Finance Intermediation (SE02)	620	380	265	446	40%	14%	£61,509	£51,899
Total	**28,738**	**32,985**	**24,198**	**31,948**	**N/A**	**N/A**	**£9,178**	**£7,773**

1 Uphold rate is based on decisions made during the year.

	New claims received		Payments made		Claims closed		Average paid	
	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16	2016/17	2015/16
General Insurance Provision (SB01)[1]	7,987	13,911	18,782	19,164	16,331	12,395	£4,076	£4,578

1 Does not include protection of 731,541 policyholders of Enterprise and Gable.

Mix of claims

General Insurance Provision

There were several high-profile failures during the year. Enterprise, domiciled in Gibraltar, failed on 28 July 2016. Then, Gable, an insurer domiciled in Liechtenstein, failed on 17 November 2016, testing once more our capacity to handle unexpected failures.

Enterprise was the largest failure of the year and at the time had more than one million UK customers. When a general insurer fails we have some flexibility in how best to protect policyholders. For cancelled policies we are obliged to refund premium, but doing this case-by-case is often less convenient for policyholders and more expensive and time-consuming for FSCS and its levy payers. So, where possible, we aim to transfer policy portfolios or arrange payment to facilitate new cover, which gives customers continuity.

Enterprise

Enterprise was permitted to write all types of general insurance in the UK but had mainly issued motor, extended-warranty insurance and certain niche policies. At the point of insolvency, 12,500 claims on motor insurance policies were made.

To date, FSCS has paid over £41m in compensation to Enterprise policyholders, with £21m paid on motor claims for own-damage and third-party loss. For return of premium, we have paid 66,561 claims at a cost of £13m – an average of £195 per claim – by working directly with more than 20 insurance brokers.

FSCS will continue paying indemnity claims over the next 18 months to three years. A few very high-value claims will still be live beyond 2020. We estimate that the indemnity claims will cost around £70m once the run-off of claims concludes.

We expect to conclude payments for return of premium claims over the coming months. These may total more than 500,000 claims at a probable cost of £35m – an average of £70 per claim.

In total, compensation costs for Enterprise could amount to £105m.

Gable

Gable was permitted to write certain types of general insurance in the UK such as motor, property and a broad range of commercial insurance policies. It had about 50,000 policyholders.

As of 31 March 2017, we have protected 21,415 policyholders by returning their premiums at a cost of £6.5m – an average of £304 per claim. We have also paid out £2.3m on 370 indemnity claims.

We expect the run-off of indemnity claims for Gable will take longer than Enterprise, as many employers' liability claims were outstanding. We expect most of these to be settled this year, but there will still be claims to manage beyond 2020.

In total, compensation costs for Gable may be around £70m.

Life and Pensions and General Insurance Intermediation

We continued to receive a high number of SIPP-related claims and claims for mis-selling of Payment Protection Insurance (PPI).

We received 7,624 PPI claims during the year, a decrease of one per cent on 2015/16. Seventy-three per cent of our PPI claims come from claims management companies. SIPP-related claims typically involve advice given by financial advisers to move pension savings out of existing occupational pension arrangements and invest in other investments within SIPP wrappers. These investments are often high risk and unsuitable for most investors. Their riskiness means some investments inevitably fail and become illiquid. This trend began two years ago and has continued this year, with claims against an increasing number of failed life and pensions advisers. Over the past year, FSCS has paid compensation of £105m for SIPP-related claims compared with £78m in the previous year – an increase of 35 per cent.

Home Finance Intermediation

Over the past year, we have seen a notable increase in compensation claims against mortgage brokers following the Emptage case.
Ms Emptage was advised to borrow money secured against her residential property in order to purchase an 'off plan' property in Spain. A Court of Appeal ruling concluded that the mortgage advice Ms Emptage received was negligent and that redress payable for losses caused by the regulated mortgage advice included losses arising from the (unregulated) property investment.

The vast majority of claims in this category relate to a specific firm, Fuel Investments Limited, which had around 750 customers. To date, the majority of these claims have been eligible.

Investment Intermediation

As in previous years, FSCS continued to see many Investment Intermediation claims against independent financial advisers regarding negligent advice to invest in unsuitable pooled investments. However, this year no firms have been placed into the Special Administration Regime, which has seen large numbers of claims in recent years.

Deposits

FSCS compensates depositors when a bank, building society or credit union becomes insolvent. During the year, we dealt with three credit union failures and compensated more than 8,647 customers at a total cost of £2m. The average time from placing a credit union into default to compensating customers was two days – comfortably within our seven-day timeframe. In the case of the South Coast Credit Union, where members received income or benefits into accounts with the credit union, we worked closely with the IP to minimise the disruption by facilitating access to funds in members' locality.

ANNUAL REPORT FROM THE INDEPENDENT INVESTIGATOR

I was in post for almost a year before my first case came to me. Now I have dealt with a second complaint. Both cases were straightforward and I was satisfied that there was no unreasonable delay in the FSCS dealing with a case, nor was any inappropriate action taken within FSCS.

The claims team are improving and updating their processes within the organisation, which should result in more clients being satisfied more quickly.

I believe that my post remains an important safety valve at the end of the process, for the small minority of people who choose to call upon it.

David E Bland PhD FCII FIRM CFCIPD
Independent Investigator
May 2017

STRATEGIC & PERFORMANCE REPORT
05 BEING READY TO RESPOND

We report on the importance of customer data and relationships with third parties in preparation for failures

Business resilience and continuity planning

Alongside its day-to-day service, FSCS needs to be able to gear up rapidly to deal with major failures if a crisis happens. This is when our ability to protect consumers and underpin financial stability is most needed.

To be prepared, we maintain a core capability to run a claims-handling system and have in place up-to-date and well-practised continuity and contingency plans. We also ensure that FSCS conforms to new regulatory requirements and contributes constructively to the development of policy where our expertise in protecting consumers is relevant.

Our resilience testing during the year led us to conclude that we can restore our claims-handling processes in the event of a major incident that would prevent us conducting business as usual from our offices.

FSCS has documented and agreed contingency plans, protocols and working arrangements with the UK Authorities. We continue to seek opportunities to further develop our resolution planning options, to ensure the most appropriate outcomes for customers, with minimum disruption to their ability to access money. In 2017/18, this will involve carrying out stress testing of our deposit readiness (see page 20) under guidance issued by the European Banking Authority.

Readiness for depositor payout

Under legislation passed in the wake of the 2008 financial crisis, the Bank of England has responsibility for overall resolution strategy and the approach to be used to resolve individual firms. The Financial Conduct Authority (FCA) has responsibility for any conduct issues that may arise. HM Treasury has a continuing interest in financial stability and any implications for the taxpayer.

FSCS is, in effect, the delivery partner if the Bank of England decides that the best way to resolve a failing deposit taker is to put it into insolvency and pay out its depositors. FSCS then steps in to make that payout. We can also be asked to contribute financially to other resolution options – a transfer of accounts to another bank or building society, for example. That is what happened when Bradford & Bingley failed in 2008.

There is also another partner in a payout: namely, the insolvency practitioner (IP) appointed by the Bank of England. The relationship with the IP is critical to an orderly resolution and to the protection of consumers. Central to this relationship is the provision of data.

In the case of a bank or building society failure, we rely on the IP to see to it that a fit-for-purpose Single Customer View (SCV) file is provided to us on time. This file, which contains information about the aggregate balances of all the failed firm's depositors, underpins our ability to get people's money back to them in seven days.

New rules came into effect in December 2016 governing the content of SCV files to take into account lessons learned from the recent past and to support continuity of access to deposits during resolution. Firms are also now required to submit their SCV file within 24 hours of request. We published a revised guide for the content and format of SCV files in response to frequently asked questions from deposit takers.

The Bank of England asks us to test a minimum number of SCV files to ensure readiness for payout. In total, during the year we tested more than 100 files from institutions such as banks, building societies and credit unions to understand whether their files were fit for purpose.

For future testing, a pilot of the SCV file self-verification service was conducted in 2016. We have implemented some improvements following feedback from the pilot and will work closely with the Bank of England to determine how to roll out this service to deposit takers in the near future.

STRATEGIC & PERFORMANCE REPORT
06 OUR PEOPLE

How investment in skills and teamwork helps us deliver a service of which our staff feel proud

Our people strategy
We are committed to the development and well-being of our people. We believe that FSCS makes a difference and that everyone within it can make a difference too.

Overview
We have recognised that the Scheme's aims will only be achieved through significant change and transformation of our systems, our processes and our people. Our customers, outsource partners and internal teams will increasingly depend on our IT and data infrastructure and on the quality of working relations. This is why we have focused on strengthening our capability through recruitment, reducing our reliance on contractors and reshaping our Executive Team.

FSCS has a permanent staff of 200 people as at 31 March 2017.

Our employees are recruited from a wide range of professions, from web developers to lawyers, finance to HR, project management to communications and beyond. We all share a common goal: to deliver excellence, which is central to the outcomes we achieve.

We invest in our staff so they have the knowledge, skills and competencies to perform effectively, fulfil their potential in their current job, and are prepared for changes in an existing role or when they move to a different job in the Scheme. Our continuing success depends on the calibre of people we employ so we work with our recruitment partners to select and recruit colleagues with the right blend of skills, qualifications, competencies, experience, knowledge and attitude.

Over the last 12 months, we have provided more than 250 learning events including nearly 80 technical training sessions, with 30 per cent of our overall offering specifically aimed at driving new and improved ways of working. We have sponsored, in full or in part, the professional qualifications of nearly 60 colleagues and for the first time participated in the MSc in Financial Regulation programme in partnership with the Financial Conduct Authority (FCA).

We conducted our annual people survey with Best Companies to understand how FSCS is perceived. As in the previous year, FSCS was scored as 'one to watch'.

Our Values – accountability, challenge, collaboration

Following the redefinition of our Corporate Values last year, we have continued to emphasise the key qualities of accountability, challenge and collaboration.

"Accountability is about taking personal responsibility for what we do and say. You can only make one person do the right thing and that is yourself."

"Owning and taking responsibility for the decisions we make and accepting and learning from those that can be learned from."

Accountability

- We always do what we say we will do. People can trust us to deliver.
- We put FSCS and what FSCS is trying to achieve above all else.
- We have the humility to acknowledge when we make mistakes and learn from them.

"This is all about being confident and bold to initiate change. See it through. Never be afraid to challenge the status quo; nothing is as certain as change."

"Having the conviction to question the status quo, and the courage, confidence and curiosity to not always accept the 'that's the way we've always done it' attitude. It is about pushing each other for the best outcome possible for the organisation and is the driving force behind consistently improving the way we work."

Challenge

- We encourage constructive and appropriate challenge.
- We are brave and honest in questioning each other and receptive to questions ourselves.
- We strive daily to add greater value for all our customers.

"This is what we should all be doing – working together to achieve our common goal of resolving claims for customers."

Collaboration

- We believe in our collective strength. We work better together.
- We respect each other's expertise and use it to achieve common goals.
- We work as one to do what we agree is right.

"For me, collaborative working means working together with people and breaking silos. It is about sharing knowledge, building on ideas and pushing for a common goal."

Our structure

The Board delegates day-to-day management of FSCS to the Chief Executive. The Chief Executive may also delegate authority for aspects of FSCS's day-to-day running to other officers or employees of FSCS. In the first instance, delegation is usually to members of the Executive Team.

In addition to the Chief Executive, the Executive Team consists of the Chief Operating Officer, Chief Financial Officer, Chief Information Officer, Director of Corporate Affairs and the Head of People. The Executive Team meets most weeks and the Head of Risk attends by invitation. The new Chief Operating Officer organisation structure is well under way, which through the role of the Chief Information Officer brings together IT, data and change management to ensure FSCS moves forward with a clear systems architecture to support our developing digital compensation strategy.

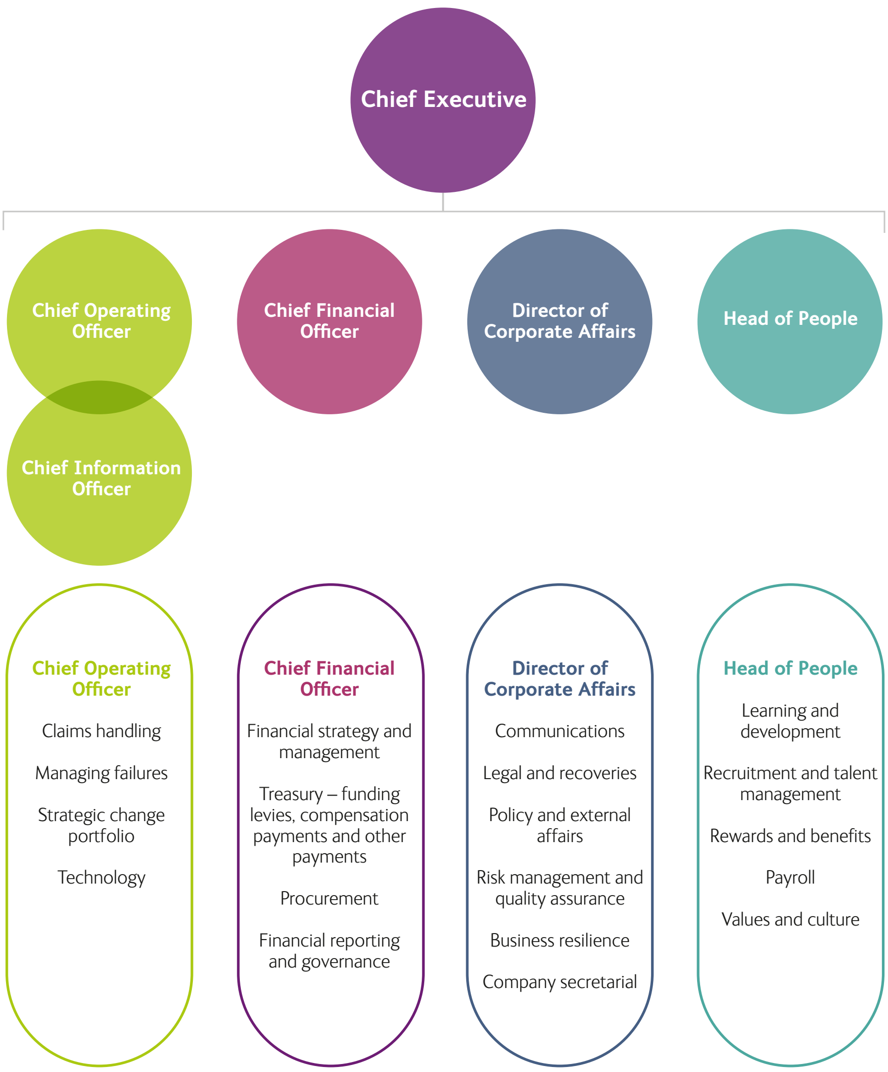
An updated Head of Risk role has been established during the year as part of our refreshed risk management framework.

Rewards and recognition

At FSCS, we promote a total rewards approach, bringing together pay and wider benefits into a single reward package that seeks to communicate what FSCS is about, what we are trying to achieve and what we value and reward. This is about looking at everything the Scheme has from cash to culture, and finding a range of innovative ways to value people for different things.

During the year, we refreshed our employee benefits package to provide greater choice and introduced self-service. We wanted to offer greater employee choice and flexibility while maintaining a level of employee benefits that was competitive in the recruitment marketplace. We were also keen to ensure that this exercise did not raise our costs. In fact, our retendering of the benefits package led to lower premiums across almost all products. Our work has been shortlisted in the Employee Benefits Awards 2017.

Overview of the current organisation structure and functions



> We celebrate diversity and promote an inclusive workplace.

THE LAWYER Awards 2016 in association with TRAVELERS
In-house Public Sector Team of the Year
WINNER

HR EXCELLENCE AWARDS 2016
WINNER

STARS, our monthly staff thanks and recognition scheme, was launched to recognise the ideas, innovation and difference individuals contribute to the Scheme's success. In addition, our annual People and Long Service awards recognise both the contribution of our colleagues during the previous year and the dedicated service and commitment of those who have worked for the Scheme for more than five years – our longest-serving employees have been with FSCS for more than 20 years.

During the year, both the Legal and People teams were recognised externally for their work. The Legal Team won The Lawyer's In-house Public Sector Team of the Year award in 2016, the first team to do so twice. The judges were impressed by the range of complex work conducted in the recoveries area.

The People Team was recognised in the HR Distinction Awards and the HR Excellence Awards in 2016 for its commitment to creating and maintaining an attractive and professionally stimulating work environment.

Diversity and inclusion

At FSCS we celebrate diversity and promote an inclusive workplace. This is an environment where everyone is treated with dignity and respect, and where the talents and skills of different groups and individuals are valued.

Over the past year, we have continued our involvement with a number of programmes: Opportunity Now, Race for Opportunity, Stonewall Diversity Champions, 30% Club mentoring scheme, Business Disability Forum and Interbank LGBT Network.

FSCS has been shortlisted for the Aviva Award for Championing an Ageing Workforce following its focus on mid-career conversations and support for and retraining of older workers as part of the Retrain work stream of the Government's new campaign for Age at Work.

Women@FSCS was launched during the year as an inclusive forum to raise awareness and discuss matters affecting women at FSCS and in the workplace generally. The network now has its own electronic community, allowing relevant events and news to be made available to all Women@FSCS members. Talks from internal and external speakers have been held and Women@FSCS representatives have joined the broader Women in Finance network.

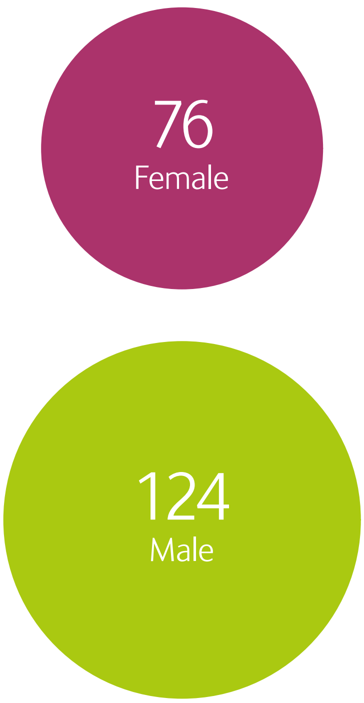
The figures opposite summarise FSCS employee numbers by category and ethnicity as at 31 March 2017.

Corporate social responsibility

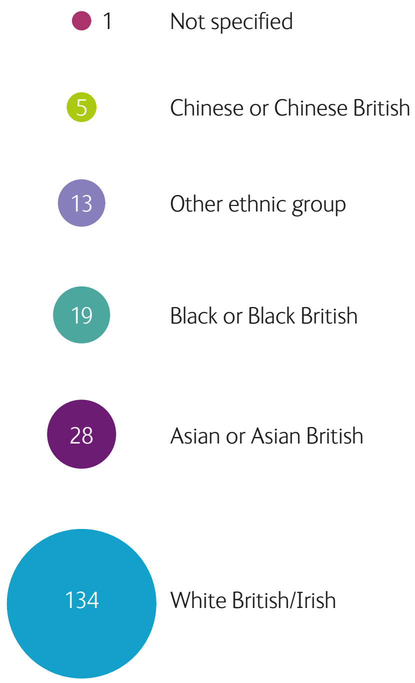
The FSCS corporate social responsibility programme (CSR) allows all permanent or fixed-term contract staff two days of paid leave to support volunteering within the wider community. During the year, more than 59 per cent of our staff attended at least one CSR event. Our staff assisted more than a dozen charities including Spitalfields City Farm (www.spitalfieldscityfarm.org/) and the Friends of Tower Hamlets Cemetery Park (www.fothcp.org/), as well as the East London Pensioners Club. We visited local schools in East London and invited students into our offices. Some colleagues support pupils at St Paul's Primary School in Whitechapel through a regular reading group.

Diversity and inclusion

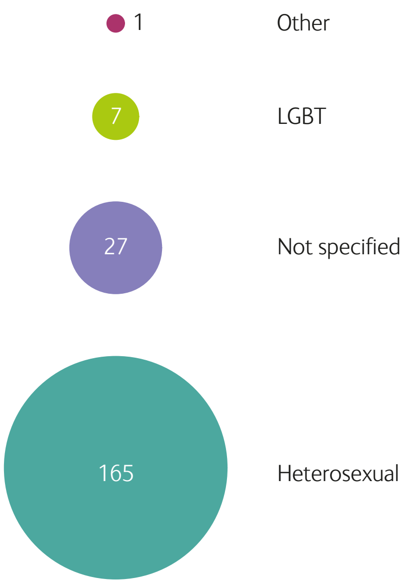
FSCS employee numbers by gender determination



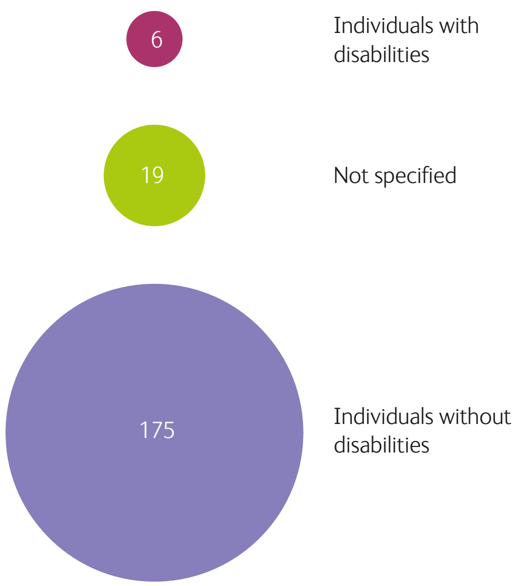
FSCS employee numbers by ethnic identity



FSCS employees by sexual identity



FSCS employees by individuals with disabilities



STRATEGIC & PERFORMANCE REPORT
07 FINANCIAL REVIEW

A summary of FSCS's financial strategy, position and outlook

Introduction
FSCS's financial strategy supports our delivery of an efficient and effective compensation service that builds consumer confidence and contributes to the UK's financial stability.

In fulfilling this strategy we have two main aims. First, that we have enough money to pay customers compensation when required to do so and, second, that we have strong control over our management expenses, demonstrating value for money for levy payers.

Value for money – increasing efficiency
We continually challenge ourselves to maintain an efficient, effective and well-run Scheme. We have simplified our claims-handling process to be more responsive to the higher number of claims received and to improve control. Working with our partners, we have improved our processes with the number of claims processed outside our service level decreasing to 2 per cent at March 2017 from 29 per cent in April 2016.

Our investment in a single online claims service will allow us to process more claims and we will continue to invest in this service to provide access to a greater number of customers.

We restructured our business support functions to strengthen our capability and to enhance our support for Scheme operations.

We introduced activity-based costing (ABC) to improve the links between planned spending, the results we get for our stakeholders and our statutory obligations.

ABC will also be used as a benchmark. We intend to present our financial performance in both ABC and the Management Expenses Levy Limit (MELL) formats.

Regarding recoveries, we focus on monitoring our effectiveness by tracking costs and recoveries over the life of the estate or recoveries actions.

Procurement works to ensure that the award of new contracts provides high quality and improved value for both the Scheme and our stakeholders. Implementing an electronic tender service has streamlined the procurement process and brought us into line with best practice and the latest public procurement regulations.

We renegotiated several IT contracts by renewing our focus on our sourcing strategies and bundling of services; this resulted in savings in excess of £500,000. We'll continue to review our sourcing strategies annually to further support our drive to achieve economies of scale across our supplier base.

Our financial framework and governance

Overview

FSCS is funded by the financial services industry. Section 213 of the Financial Services and Markets Act 2000 (FSMA) gives FSCS the power to impose levies on authorised firms to meet its expenses, including the cost of compensation, borrowing and insurance of risks. The Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) are responsible for the rules governing the Scheme's funding arrangements. Our financial framework is also governed by a Memorandum of Understanding with HM Treasury.

Our accounts are consolidated into HM Treasury Group annual resource accounts. Through interim and final accounts consolidation processes, we provide HM Treasury with appropriate reassurances on the operation of systems, controls and processes that underpin the production of our accounts within relevant levels of materiality, which represent a true and fair view.

Business planning and budgets

We have an annual business-planning cycle and prepare forecasts internally on a quarterly basis. This process supports the Scheme's overall three-year financial plan to achieve our imperatives and fulfil our strategic plan.

Our annual budget is approved by the PRA and FCA boards in December. Once agreed, it is consulted on by the industry. Our Plan and Budget is presented to stakeholders in the financial services industry as part of an annual stakeholder event in January.

Unlevied reserve

During the year, we experienced unforeseen claims regarding the Enterprise Insurance Company PLC (Enterprise) and Gable Insurance AG (Gable) failures and Self-Invested Personal Pensions (SIPPs). These created the need to raise supplementary levies to cover increased compensation costs. In responding to these challenges, our claims-handling costs went £4.1m over budget. Through savings and efficiencies, we absorbed £2.1m of these additional costs within our budget.

We used £2m of the unlevied reserve to cover the rest of our cost increase. The unlevied reserve is in place to deal with an unexpected number of claims. We advised the PRA and FCA in advance of our intention to use the unlevied reserve and also notified the industry.

Treasury management

FSCS is a cash business funded by industry levies. Levies are typically received in the second quarter of our financial year and we are required to hold funds in excess of £20m on deposit at the Bank of England.

Our liquidity is underpinned by an overdraft facility of £20m and a revolving credit facility of £1.1bn underwritten by a syndicate of banks. In March 2017, the revolving credit facility was increased to £1.3bn.

FSCS can also access funds from HM Treasury, if required, through the National Loans Fund or any other appropriate source.

Annual Report and Accounts

Our Annual Report and Accounts are prepared under the Companies Act 2006 and International Financial Reporting Standards as adopted by the EU (IFRS). This year, in addition to the Annual Report and Accounts, we are publishing the Class Statements in a separate document, as required under FSMA, for our levy payers, trade bodies and financial services regulators. Class Statements summarise the source and application of funds from our levy payers by class so that levy payers can follow levies set at the beginning through to the end of the financial year. Our 2016/17 Class Statements may be found on our website at www.fscs.org.uk/industry/publications/.

The year in summary

Levy income and compensation

	Year ended 31 March 2017 (£'000)	Year ended 31 March 2016 (£'000)
Compensation costs	375,262	270,869
Recoveries income	(130,362)	(62,780)
Levy income for compensation costs	**244,900**	**208,089**

Levies for compensation paid have increased by £104m, the explanation for which is shown below. Levies in respect of compensation costs are net of recoveries income which has increased by £67m.

Other levy income for management expenses	Year ended 31 March 2017 (£'000)	Year ended 31 March 2016 (£'000)
Base costs	21,450	18,639
Specific costs	48,363	48,561
Loan interest	306,246	336,724
Pension obligations	(1,668)	(3,325)
Total management expenses	374,391	400,599
Total levy income	**619,291**	**608,688**

Other levy income for management expenses has reduced by £26m. This reduction arises mainly because of the levies for loan interest which have reduced by £30m. This is caused by repaying the loan associated with Kaupthing Singer & Friedlander Limited and a reduction in 12-month LIBOR. Interest on the loans with HM Treasury is charged at the higher of 12-month LIBOR plus 111 basis points or the relevant bond rate published by the Debt Management Office. Levies recognised in the financial statements are adjusted for a deferral of levies for the remainder of the levy year to 30 June 2017.

Compensation costs

Funding class	Year ended 31 March 2017 (£'000)	Year ended 31 March 2016 (£'000)
2008/09 banking failures	5	16
Deposits (excluding 2008/09 banking failures)	(3,323)	8,632
General Insurance Provision	154,032	87,586
General Insurance Intermediation	12,399	8,991
Life and Pensions Provision	–	(16)
Life and Pensions Intermediation	104,773	83,810
Investment Provision	8,779	1,637
Investment Intermediation	82,327	77,108
Home Finance Intermediation	16,270	3,104
Total compensation costs	**375,262**	**270,868**

Total compensation costs have increased by £104m. The largest increase, of £66m, is in the General Insurance Provision class which is attributable to unforeseen compensation costs for the failures of Enterprise and Gable. Life and Pensions Intermediation compensation costs increased by £21m because of SIPP-related claims. Compensation costs in the Home Finance Intermediation class increased by £13m to deal with the failure of Fuel Investments Limited.

The total value of compensation paid in the year was £351m. Compensation costs, as above, total £375m as they include provision for £24m for future compensation payments estimated but not paid at the balance sheet date.

Recoveries
Recoveries income in the year was £130m, up from £63m in 2015/16. Recoveries receipts during the year amounted to £68m. The balance is accounted for by the change in assumptions about future recoveries year on year.

Administrative expenses
During the year, administrative expenses increased from £66m to £68m, primarily because of additional bank charges of £1.1m associated with the revolving credit facility which increased from £750m to £1.1bn. The size of the facility is based on available capacity in the Deposits class after forecast levies, which was £750m in 2015/16. For 2016/17, the forecast levy for legacy failures including Bradford & Bingley (B&B) interest reduced from an estimated £750m to around £400m, giving £400m of extra capacity which drove the increase in facility size to £1.1bn.

Pension costs
FSCS administers a money purchase scheme in which all employees are eligible to participate and receive an employer contribution of at least 6 per cent.

Our defined benefit pension scheme has been closed to new members and future accrual since 30 June 2011. A contribution of £2m (£1.9m in 2015/16) was made during the year to honour our commitment to eliminate the pension scheme deficit by 2022.

Interest payable
The loan from HM Treasury to fund the resolution of B&B in 2008 continues to accrue interest with £306m (£337m in 2016) charged during the year. The relevant amount will be levied to firms in the Deposits class before 1 September 2017.

Balance sheet

Bradford & Bingley
On 31 March 2017, HM Treasury announced the sale of portfolios of mortgages generating sale proceeds of £11.8bn. This meant repaying £11bn to FSCS, which was applied on 25 April 2017.

Accordingly, an amount of £11bn has been reclassified in the statement of financial position on page 88 as due within a year. The Board has assessed the status of the remaining £4.7bn receivable and continues to consider that this should be recognised in full.

B&B has also announced that it will explore further asset sales. This has the potential to create future additional repayments to FSCS. The repayment received in April 2017 has significantly reduced the balance on FSCS's loan from HM Treasury and this will significantly reduce the interest expenses accrued and ultimately levied on banks, building societies and credit unions.

Dunfermline/other legacy banking estates
We received a final dividend in the London Scottish Bank plc administration, bringing the total realised to 63.4p in the pound and concluding our involvement in this estate. We have continued to receive dividends from the estates of Kaupthing Singer & Friedlander Limited to reduce costs for levy payers. We also expect a further final dividend from Heritable Bank plc.

We have continued to work with the administrators of Dunfermline Building Society and with HM Treasury to finalise FSCS's liability to contribute to the costs of resolution in 2009, including making three interim payments totalling £500m. As a result of recoveries received to date from other estates, we do not expect to levy the industry any more for that failure.

Defined benefit pension scheme
At 31 March 2017, the deficit on the defined benefit scheme was £2.68m compared with a deficit of £4.35m at 31 March 2016.

The decrease in corporate bond yields after the EU referendum in June 2016 increased the valuation of the pension obligation. However, this was offset by the increase in fair value of pension scheme assets.

Triennial valuations of the scheme form the basis of annual contributions made into the scheme. A funding valuation of the scheme was last carried out in April 2015 and resulted in an increase from £1.6m to £1.9m in annual contributions to the scheme.

> “
>
> The total value of compensation payments in the year was £351m.

Critical accounting judgements and key estimation uncertainties

The key areas of uncertainty and judgement in the financial statements are as follows:

Compensation costs

Compensation costs consist of compensation payments made during the year and a provision for future compensation not paid. The provision is the best estimate of compensation that has been offered but not paid at the balance sheet date, plus our best estimate for future return of funds and return of premium payments for existing failures, that have not yet been paid.

Levies and recoveries

We have made judgements about the timing and amount of claims arising in the year from which we set our levy. Levy income is recognised after taking into account costs associated with the compensation scheme. Any surplus or deficit in levy income is deferred as payable to or receivable from levy payers.

We estimate the timing and value of recoveries receivable based on information available to the directors at 31 March 2017, including insolvency practitioners' statements of likely outcomes, other reports published as part of the various insolvency processes and legal advice on potential recoveries through litigation. Nevertheless, the timing and final outcome of recoveries are uncertain.

Outsourced claims-handling costs

Outsourced claims-handling costs consist of (a) invoices paid during the year and accruals for decisions made but not invoiced and (b) the cost of claims at various stages of the claims-handling process, which we call work in progress.

Compensation payments

The total value of compensation payments paid in the year was £351m. Compensation costs, as recognised in the financial statements and the Class Statements, total £375m, as they also include a provision for £24m for future compensation payments.

Legacy banking estates

We measure financial assets associated with the 2008/09 banking failures at their fair value. We have not subsequently measured them at amortised cost using the effective interest rate. This is because doing so would create a difference between the carrying value of the receivable and the associated liability to HM Treasury which would not represent the economic reality.

Looking forward

Plan and Budget

Our 2017/18 Plan and Budget published on 16 January 2017 focuses on promoting and developing our digital service. By March 2019, we aim to receive the vast majority of claims applications online.

In our Payment Protection Insurance (PPI) recovery action against lenders, based on the Supreme Court's decision in *Plevin v Paragon Personal Finance Ltd* (2014), we have already achieved significant recoveries. With a budget set aside specifically for this, FSCS will continue to pursue this recovery.

FSCS funding review

We were actively engaged with regulatory authorities and the financial services sector on the FCA review of the FSCS funding model. On 14 December 2016, the FCA published consultation paper CP16/42, *Reviewing the Funding of the Financial Services Compensation Scheme (FSCS)*.

It sought industry feedback on the following:

- the professional indemnity insurance (PII) market, and the coverage it provides;
- introducing product provider contributions;
- changing and/or merging funding classes for intermediation activities;
- consideration of risk-based levies; and
- updating FSCS compensation limits in light of pension freedoms.

The consultation also proposed extending the scope of FSCS protection to include client money held by authorised debt-management businesses, investment advice on structured deposits, and the ability of FSCS to 'look through' claims from collective investment scheme (CIS) participants.

The consultation, which closed on 31 March 2017, generated great interest and industry engagement.

We will continue to work with the regulatory authorities and the financial services community on the funding review, encouraging active engagement of trade bodies and industry firms.

GOVERNANCE REPORT
08 CORPORATE GOVERNANCE

Robust corporate governance underpins our activities

Overview
The FSCS Board is committed to high standards of corporate governance. As the Scheme is not a listed company, it need not comply with the UK Corporate Governance Code (the Code). However, to ensure best practice, the Board has chosen voluntarily to follow it.

This section explains how FSCS has applied the main principles of the Code and where it has departed from some of the Code's provisions. The Scheme complied throughout the year with the Code issued in April 2016, except for the provisions listed at the end of this section.

The Board

Board composition
The FSCS Board consisted of 11 directors at 31 March 2017, seven of whom are non-executive directors, including the Chairman. The biographies of the directors are set out on pages 60 to 63.

The appointment and removal of Board members is made by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The appointment, reappointment and removal of both the Chairman and the Chief Executive are also approved by HM Treasury. All appointments and reappointments of directors are for periods of no more than three years. The appointment process is overseen by the Nomination and Governance Committee and is described on page 57.

Board changes:

Name	Position	Date of leaving	Date of appointment
David Weymouth	Non-executive director	31 December 2016 – resignation	
Liz Barclay	Non-executive director	30 June 2017 – expiry of term	
Jayne Nickalls	Non-executive director	30 June 2017 – expiry of term	
Steven Cooper	Non-executive director		1 July 2017
Patrick Neville	Non-executive director		1 July 2017
Helen Parker	Non-executive director		1 July 2017

The Board considers all non-executive directors to be independent, and all directors are also subject to a conflicts of interest policy to prevent any potential interference with the independence of their judgement on Board matters.

FSCS actively seeks diversity on the Board and ensures this is considered as part of the recruitment process. Board appointments continue to be based on merit, measured against objective criteria, and the skills and experience the individual can bring to the Board. Accordingly, FSCS has not set specific measurable objectives for how it applies its Board diversity approach.

Operation of the Board
The Board has a formal schedule of matters reserved for its decision which includes:

- setting FSCS's strategic decisions;
- setting policy;
- overseeing FSCS's operations and reviewing the Scheme's performance;
- approving the Plan and Budget;
- approving levies above specified limits; and
- responsibility for the risk management and internal control systems.

Certain matters are delegated to committees of the Board and these are described in each committee's terms of reference. The duties of the Audit Committee, Risk Committee, Remuneration and Human Resources Committee, Nomination and Governance Committee and Claims Decisions Committee are summarised in this report.

The Board met 10 times during the year and held two awaydays, at which the strategic direction of FSCS was reviewed.

The Board believes that it receives and has access to, on a timely basis, the relevant information needed to make appropriate decisions. Directors review this on an ongoing basis to ensure that the Board continues to receive sufficient, accurate, timely and clear information.

The Company Secretary, appointed by the Board, attends all Board and committee meetings, and is responsible for ensuring that Board procedures are followed and that appropriate records are kept. Directors are permitted to obtain independent professional advice, as required, on any matter that may help them carry out their duties.

Induction and training

New directors are involved in a comprehensive induction process designed to enable them to become familiar quickly with FSCS. Their induction includes meeting existing Board members and staff across several key business areas and visits to outsourced claims handlers.

Directors are also offered training as part of their continuing professional development. They take up opportunities to refresh their knowledge and skills so they can stay up to date on specific FSCS issues, their duties as directors, and with industry and regulatory changes. External speakers are also invited to discuss relevant matters with the Board from time to time.

Director appraisal

The Chairman met each of the non-executive directors and the Chief Executive individually to carry out an annual performance review. This included feedback from other directors taken as part of the annual Board effectiveness review described below and from the Chairman's regular discussions with directors outside formal meetings. The Deputy Chairman carried out the Chairman's performance review on the Board's behalf, and the Chief Executive carried out the performance reviews of the other executive directors.

Board effectiveness review

In late 2016, the Board conducted an annual review of its own effectiveness and that of its committees. It used an online feedback form containing detailed questions on how the Board works together and its balance of skills, experience, independence, company knowledge and diversity.

To supplement the annual review, the Chairman maintained regular contact with directors outside formal Board/committee meetings to obtain views on Board performance and met the non-executive directors from time to time without executive directors present.

The key points raised in the review were discussed by the Board in December 2016. These included seeking more opportunities for the Board to meet outside formal Board meetings – both as a whole and for non-executive directors only – and with the management group.

Statement of Accounting Officer's responsibilities

HM Treasury has designated the Chief Executive as the Accounting Officer for FSCS. His responsibilities as Accounting Officer are in the FSCS and HM Treasury framework document. These responsibilities broadly include:

- ensuring the regularity and propriety of public funds;
- keeping proper records;
- day-to-day operations and management of FSCS and performance reporting; and
- ensuring appropriate standards of governance, decision-making and financial management are maintained.

Board committees

Audit Committee

Committee members as at 31 March 2017

- Paul Stockton (Chairman)
- Mark Adams
- Marian Glen
- Charles McKenna

The Board is satisfied that at least one member has recent and relevant financial experience and that the Audit Committee as a whole has competence relevant to FSCS's role.

The Committee met four times during the year and reported to the Board after each meeting.

The Chief Executive, Director of Corporate Affairs, Chief Financial Officer, Head of Internal Audit and external auditors attend most meetings by invitation.

Roles and responsibilities

These are set out in the Committee's terms of reference. Its key responsibilities are to review the financial reporting process, the system of internal control, the audit process and the company's processes for monitoring compliance with law and regulation.

What the Committee has done

Governance

During the year, the Committee:

- supported the introduction of the enhanced risk and control framework led by the Risk Committee;
- reviewed the internal arrangements for control;
- held discussions with both internal and external audit without the Executive;
- reviewed our compliance with laws and regulations, and our health and safety obligations;
- received reports on whistleblowing, fraud, money laundering and data protection;
- considered reports on quality assurance reviews; and
- reviewed the FSCS insurance policies and considered directors' indemnities.

Financial reporting

The Committee:

- considered the significant accounting judgements and estimates made in connection with the financial statements together with the appropriateness of the accounting policies;
- considered the appropriateness of the going concern presumption; and
- reviewed the Annual Report and Accounts and made recommendations to the Board, following which the Board concluded that the Annual Report and Accounts, taken as a whole, was fair, balanced and understandable, and gave enough information to enable the company's performance, business model and strategy to be assessed.
- reviewed the Annual Report and Class Statements prepared under Section 218 of the Financial Services and Markets Act 2000.

Internal audit
The Committee:

- set and reviewed the internal audit plan;
- reviewed a selection of internal audit reports around data protection, cyber security and document retention;
- reviewed and approved the internal audit policy; and
- carried out its annual review of the internal audit function.

The Head of Internal Audit had separate discussions with the Chairman of the Audit Committee.

External audit
The Committee:

- reviewed the external audit process, including the performance of the external auditors, by gathering feedback from management and Committee members.

The external auditors did not perform any non-audit services during the year.

Risk Committee

Committee members as at 31 March 2017

- Charles McKenna (Chairman)
- Mark Adams
- Liz Barclay
- Jayne Nickalls
- Paul Stockton

The Committee met four times during the year, and reported to the Board after each meeting.

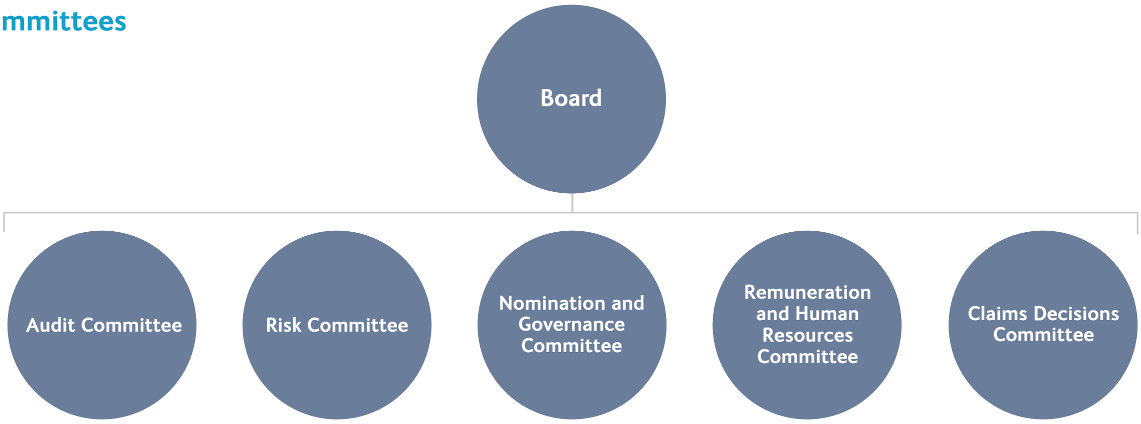
The Chief Executive, Director of Corporate Affairs, Head of Risk and Head of Internal Audit attend most meetings by invitation.

Roles and responsibilities
These are set out in the Committee's terms of reference. Its key responsibilities are to review FSCS's risk management approach, its approach to risk tolerance and its mitigation of those risks. It also reviews FSCS's contingency planning arrangements and disaster-recovery plans.

What the Committee has done
During the year, the Committee:

- reviewed and refreshed FSCS's risk management by introducing a new risk and control framework, incorporating a strengthened three lines of defence model, and defining a 'Risk Universe' for the Scheme – this enhanced risk and control framework is detailed further on page 71;
- carried out reviews of the Scheme's risk profile at each meeting;
- conducted the annual review of the risk management policy;
- reviewed the contingency planning arrangement for large business failures in the financial services industry; and
- reviewed the disaster-recovery arrangements.

Board committees



Nomination and Governance Committee

Committee members as at 31 March 2017

- Lawrence Churchill (Chairman)
- Marian Glen
- Charles McKenna
- Mark Neale

The Committee met three times during the year, and reported to the Board after each meeting. Informal meetings regarding appointments and reappointments of directors together with the recruitment and selection of new non-executive directors in 2017 were also held.

Roles and responsibilities

These are set out in the Committee's terms of reference. Its main responsibilities include Board composition and succession planning, reviewing membership of the Board committees, liaising with the PRA and FCA on appointments and reappointments of Board members, and overseeing the Board's governance arrangements and other corporate governance issues.

The process for appointing and reappointing directors involves:

- the Committee discussing Board composition (including mix of skills and experience, diversity and Board size);
- engaging with the FCA and PRA on the process;
- appointing an external search consultancy for new appointments; and
- using a selection panel of FCA, PRA and FSCS representatives to make proposals for FCA and PRA approval (and HM Treasury, in the case of the Chairman and Chief Executive).

What the Committee has done

During the year, the Committee:

- co-ordinated with the FCA and PRA on the recruitment and appointment of three new non-executive directors, following the departure of three non-executive directors during 2016 and 2017;
- considered the process for appointing a new Chairman in 2018; and
- discussed reports on the Board's role in fostering corporate culture.

Saxton Bampfylde, an external search consultancy with no other connection with FSCS, was engaged in the recruitment of new non-executive directors.

Remuneration and Human Resources Committee

Committee members as at 31 March 2017

- Liz Barclay (Chairman)
- Lawrence Churchill
- Marian Glen
- Jayne Nickalls

The Committee met twice during the year and reported to the Board after each meeting.

The Chief Executive and Head of People attend most meetings by invitation.

Roles and responsibilities

These are set out in the Committee's terms of reference. Its main responsibilities include executive director remuneration, FSCS's broader remuneration policy, employee benefit structures, the ongoing development and execution of the People Strategy, monitoring corporate responsibility and overseeing diversity and inclusion.

What the Committee has done

During the year, the Committee:

- reviewed market conditions in the UK economy to help inform the proposed salary budget;
- reviewed FSCS's performance as part of its decision-making on the size of the bonus pool;
- considered further the remuneration and reward framework, and will continue this review into 2017/18, taking into account the revised principles in the UK Corporate Governance Code that relate to executive remuneration; and
- made recommendations to the Board for the approval of the Chief Executive's remuneration package and set the remuneration packages of the other executive directors, having taken into account comments from the Chief Executive. In the case of executive directors, performance and market data provided by external consultants are taken into account, and their remuneration includes a performance-related element.

FSCS engaged Twenty Six Consulting as remuneration consultants. Twenty Six Consulting has no other connection with FSCS.

A full report on directors' remuneration is given in the Directors' Remuneration Report on page 64.

Claims Decisions Committee

The Claims Decisions Committee meets on an ad hoc basis to consider marginal or unusual claims and difficult claims issues referred to it by the Executive. It consists of three directors: the Chief Executive and any two non-executive directors.

The non-executive directors are selected at the time the committee meeting is convened.

There were no cases referred to this committee during the year.

Attendance at Board and committee meetings

	Board	Audit Committee[1]	Remuneration and Human Resources Committee[1]	Nomination and Governance Committee[1]	Risk Committee[1]	Appointment date	Expiry of term
No. of meetings held	**10**	**4**	**2**	**3**	**4**		
Non-executive directors:							
Mark Adams	10/10	4/4		1/1		1 Jun 2015	31 May 2018
Margaret (Liz) Barclay	10/10		2/2		3/4	1 Jul 2011	30 Jun 2017
Lawrence Churchill	9/10		2/2	3/3		1 Apr 2012	31 Mar 2018
Marian Glen	9/10	3/4	2/2	1/1		1 Feb 2013	31 Jan 2019
Charles McKenna	9/10	1/1	1/1	1/1	4/4	1 Feb 2013	31 Jan 2019
Caroline (Jayne) Nickalls	9/10		1/1	2/2	3/4	1 Jul 2011	30 Jun 2017
Robert (Paul) Stockton	9/10	4/4		1/2	4/4	1 Dec 2011	30 Nov 2017
David Weymouth	6/7	3/3			3/3	1 Jul 2011	31 Dec 2016[2]
Executive directors:							
Jimmy Barber	10/10					4 Jan 2016	3 Jan 2019
Alex Kuczynski	10/10					1 Feb 2010	31 Jan 2019
Mark Neale	10/10			3/3		4 May 2010	3 May 2019
Kathryn Sherratt	9/10					15 Dec 2015	14 Dec 2018

1 Attendance shown only for committee members.
2 Date of resignation from Board before end of appointment term.

THE BOARD OF DIRECTORS

Executive Directors

Mark Neale
(Chief Executive)
Formerly Director General at HM Treasury responsible for Budget, Tax and Welfare until May 2010, Mark spent four years leading on the development of tax policy and delivery of the annual Budget and Pre-Budget Report, managing fiscal risk and welfare policy, including reducing child poverty. Previously he was Director General for Security at the Home Office with responsibility for Counter-terrorism and Organised Crime. This included the creation of the Serious Organised Crime Agency, and development of the Government's counter-terrorism strategy. Mark has also been responsible for welfare reform as Director for Children and Housing at the Department for Work and Pensions, and was Finance Director of the Employment Service. Mark has also been an independent member of the Council of the University of Roehampton since 2010.

Alex Kuczynski
(Director of Corporate Affairs)
Alex was previously General Counsel and, before that, Head of Legal at FSCS. His role as Director of Corporate Affairs brings together our work in areas that include legal and recoveries, company secretariat, risk management, communications and policy and external relations. Alex joined from the Investors Compensation Scheme, where he was Head of Legal, and acted as its Interim Chief Executive from March to May 2010. He is active in a number of international associations, for example as the co-ordinator of the EU Committee of the European Forum of Deposit Insurers, a member of the Executive Committee of the International Forum of Insurance Guarantee Schemes, and chairperson of the Technical Assistance Committee of the International Association of Deposit Insurers.

Kathryn Sherratt
(Chief Financial Officer)
Previously the Executive Financial Controller of the Retail Business of Barclays Bank PLC, Kathryn joined FSCS in 2012 to lead the Finance department. Appointed to the Board in 2015, her responsibilities include commercial and financial strategies, value for money and resolution. Kathryn's career started with Deloitte in the UK and Australia before joining Barclays. At Barclays, Kathryn was responsible for all financial control aspects of the Barclays Retail UK Business. Her experience includes business transformation and process improvement, offshoring, acquisitions and group reorganisations.

Jimmy Barber
(Chief Operating Officer)
Jimmy joined FSCS in January 2016, bringing together the delivery of our service to consumers and the IT and data architecture which supports that service. He worked as the Operations Development Director and (previously) as the Commercial Operations Director at the RSA Insurance Group, where he had been since 2007. In these roles Jimmy was responsible for business transformation and improvement and for the delivery of shared services across the UK. Before RSA, Jimmy held major operational roles at Capital One and at Ladbrokes.

Non-Executive Directors

Lawrence Churchill CBE (Chairman)
Lawrence is currently the Senior Independent Director at Bupa, Chairman of the Independent Governance Committee at Prudential plc, Chairman of Applegate Marketplace, a Trustee of Age UK and the International Longevity Centre (UK), and Chairman of the Pensions Policy Institute. His executive career included being Chief Executive of UK, Irish and International Life at Zurich Financial, Executive Chairman of Unum and CEO of NatWest Life and Investments. Non-executive roles included Chairman of NEST Corporation, Chairman of the Pension Protection Fund, Member of the Actuarial Standards Board, and Director of the Financial Ombudsman Service and the Personal Investment Authority. Lawrence brings over 30 years of board experience in insurance and investments, and a deep interest in governance and risk management, driven by a passion for ensuring the right outcomes for consumers.

Liz Barclay (to 30 June 2017) (Deputy Chairman and Senior Independent Director)
Liz is a writer and presenter of, and contributor to, a number of radio programmes and documentaries, as well as being a personal finance and consumer rights commentator for newspapers and magazines. She is the author of several business books, runs MoneyAgonyAunt.com, a consumer and personal finance website, and chairs national and international conferences. Additionally, Liz is a member of the Financial Services Consumer Panel and the Equity Release Council Standards Board, Chair of the Credit Union Foundation and of Citizens Advice Camden, an ambassador for the Money Advice Trust and an honorary member of the Trading Standards Institute. Liz also trains in presentation, communication and interview skills.

Charles McKenna (Deputy Chairman and Senior Independent Director from 1 July 2017)
Charles has a background in law and spent over 30 years with law firm Allen & Overy, including 22 years as a partner specialising in corporate, financial services and regulation. He has an extensive understanding of international business activity and challenges, including strategy development, corporate governance, risk management, corporate finance, restructuring and insolvency, joint ventures and other commercial arrangements. Charles also has a wealth of experience and expertise in the financial services sector where he advised banks, investment managers and brokers, financial institutions and regulatory bodies. In the 1980s, he was involved in the formation of the Securities Association, the first UK self-regulating organisation, which included advising on its constitution and rulebook. He served for three years on the board of Hart Citizens Advice Bureau.

Jayne Nickalls (to 30 June 2017)
Jayne is an experienced leader of transformational business change in both the public and private sectors, with a particular focus on digital service delivery in complex environments. Formerly Chief Executive of Directgov, Jayne spent six years leading the Directgov business (through the Cabinet Office and Department for Work and Pensions) from start-up to an established, successful business at the heart of the Government's digital strategy. Previously, she was responsible for the delivery function of Chordiant Software in northern Europe. There, she led and managed the delivery of a wide range of enterprise solutions to clients across a number of industries with large consumer bases, particularly financial services. Jayne is also a non-executive director of Jadu Limited and the Pension Protection Fund.

Paul Stockton
Paul has been Group Finance Director at Rathbone Brothers plc, a FTSE 250 company, for over eight years. He has gained exposure to a wide range of domestic and international financial services businesses throughout his career, including the insurance and banking sector. In particular, his current role promotes considerable experience in private client investment management, the provision of financial advice, and asset management. Through his work in the industry more generally, he has also established a strong understanding of issues relating to other financial services, sales, consumer matters, corporate governance and regulatory compliance.

Marian Glen
With over 25 years' experience of corporate finance, Marian was a solicitor at Linklaters in the City, specialising in M&A, joint ventures and financial services before joining Shepherd and Wedderburn where she was a corporate partner for many years. As Head of Financial Services, she worked on a range of deals in the financial services sector before being appointed UK General Counsel at the global insurer AEGON, joining its UK Executive and Global Leadership teams. Marian now has a portfolio of non-executive roles. She is a non-executive director of Shires Income plc and Martin Currie Global Portfolio Trust plc, where she also sits on their respective audit committees. In addition, Marian is an external member of the Audit and Risk Committee of the Water Industry Commission for Scotland (the economic regulator of the water industry in Scotland). She is a former non-executive director of Friends Life Group, the FTSE 100 insurance group.

Mark Adams
Mark is a chartered accountant and retired as a partner at Deloitte LLP in 2013. For 25 years, he was at the centre of resolving many of the major financial services sector failures, including insurance sector failures in the UK, Japan, Bermuda and the Channel Islands, and more recently the banking sector failures in Iceland. Mark also has extensive resolution planning experience with the UK authorities in the banking and building society sector. In addition, Mark has expertise in advising bank and bondholder lenders to financial institutions experiencing stress or undergoing restructuring processes. Mark has been a provisional liquidator, scheme administrator or administrative receiver to various financial institutions.

Patrick Neville (from 1 July 2017)
Patrick is a chartered accountant and has had an extensive career in financial services, operating in leadership roles across banking, asset management and insurance. Formerly Chief Financial Officer at Aviva Investors, Patrick was also Finance Operations Director for Aviva's UK Life and General Insurance businesses and spent 16 years with Royal Bank of Scotland, latterly as Finance Director of the Cards and Direct Finance business, after leading a number of change programmes to transform and run Finance Shared Services operations for the retail, corporate banking and wealth management divisions. He brings to the Board a strong track record in the successful delivery of large-scale change and a deep understanding of the implementation and operation of governance, risk and control frameworks in financial services. Patrick is also a non-executive director of Decisioning Blueprints Ltd, and Finance Director of Dontia Group Limited.

Steven Cooper
(from 1 July 2017)

Steven is the CEO of Barclaycard Business Solutions, managing the payments division for Barclaycard including Merchant Acquiring, Commercial Payments and Sales Finance. Within his 30 years in the banking industry, Steven was most recently CEO of Personal Banking at Barclays for both UK and Europe, where he gained a wealth of experience in the rapidly changing landscape of consumer banking with digital technology and data. He has also led UK Business Banking and businesses for Barclays in Africa, India and offshore locations. Steven sits on a number of advisory boards, including Teach First and Business in the Community's Age at Work Campaign and is an Alumni of Harvard Business School.

Helen Parker
(from 1 July 2017)

Helen is Deputy Chief Executive of Which?, Europe's largest independent consumer organisation. She has held a number of roles with the consumer body, having previously been its Director of Policy, Editorial Director and Editor of Which?. Her non-executive experience includes having been a Director of the Fundraising Standards Board, which was then the regulator of UK charity fundraising. She has also served as a Council member of Consumers International, the world federation of consumer rights groups with 200 members around the globe.

DIRECTORS' REMUNERATION REPORT

Certain parts of this report are subject to audit and these are indicated in the relevant sections.

Annual report on remuneration

Non-executive directors' fees are reviewed and set by the FCA and PRA. The Board is responsible for setting the remuneration of executive directors. The Remuneration and Human Resources Committee considers the remuneration package of the Chief Executive and makes recommendations to the Board for approval. The Chief Executive is not present when his remuneration package is being considered. The remuneration of other executive directors is determined by the Remuneration and Human Resources Committee. A fuller description of the work of the Remuneration and Human Resources Committee is given on page 58.

Directors' remuneration table for 2016/17

Audited section	2016/17				
	Fees and salary[1] £'000	Taxable benefits[2] £'000 (nearest £100)	Performance-related bonus[3] £'000	Pension[4] £'000 (nearest £1,000)	Total £'000
Non-executive					
Mark Adams	20–25	3.5	–	–	25–30
Margaret (Liz) Barclay	25–30	0.4	–	–	25–30
Lawrence Churchill	75–80	10.7	–	–	85–90
Marian Glen	20–25	8.9	–	–	30–35
Charles McKenna	25–30	0.5	–	–	25–30
Caroline (Jayne) Nickalls	20–25	0.8	–	–	25–30
Robert (Paul) Stockton[5]	0[5]	0[5]	–	–	0–5[5]
David Weymouth	20–25	0.4	–	–	20–25
Executive					
Jimmy Barber	225–230	2.1	45–50	25	300–305
Alex Kuczynski	220–225	2.3	25–30	53	305–310
Mark Neale	255–260	0.5	30–35	23	315–320
Kathryn Sherratt	165–170	0.9	20–25	15	200–205
Highest paid director's total remuneration[6] (£'000)					290–295
Median total remuneration for FSCS staff[6] (£)					49,434
Remuneration ratio[6]					5.9

2015/16				
Fees and salary[1] £'000	Taxable benefits[2] £'000 (nearest £100)	Performance-related bonus[3] £'000	Pension[4] £'000 (nearest £1,000)	Total £'000
20–25	1.9	–	–	20–25
25–30	0.1	–	–	25–30
75–80	5.0	–	–	75–80
20–25	10.4	–	–	30–35
20–25	0.1	–	–	20–25
20–25	0.6	–	–	25–30
0[5]	0.2	–	–	0–5[5]
25–30	0.2	–	–	25–30
55–60	–	–	6	60–65
215–220	2.0	30–35	50	300–305
255–260	0.3	30–35	38	325–330
45–50	0.2	5–10	6	55–60
				285–290
				45,590
				6.3

Notes:

1 The Chairman and other non-executive directors are paid fees, and executive directors are paid salaries. Executive directors do not receive fees or any additional remuneration regarding their roles as directors. Salaries and fees are stated for the financial year in respect of which they are earned and relate to each director's period of appointment. All directors were in their post for the 2016/17 year, with the exception of David Weymouth, who resigned from the Board on 31 December 2016. For executive directors, the figures in the Fees and salary column constitute basic salary, with adjustments for non-taxable benefits and other benefits subject to PAYE such as gym subsidy and annual leave sell back. More details on directors' salaries and fees are given in the relevant section below.

2 Taxable benefits represent the gross value of benefits, whether cash or non-cash, that are chargeable to UK income tax. The figures in this column include any taxable expenses directly and properly incurred in the performance of FSCS duties. For the Board as a whole, these taxable expenses amounted to £26,800 in 2016/17 (2015/16: £18,900) (to the nearest £100). The majority of these additional taxable expenses relate to non-executive directors' travel to FSCS, and any associated subsistence, for attending Board and committee meetings, and include the associated income tax and National Insurance liability, which is met by FSCS as agreed with HM Revenue & Customs. For executive directors, these benefits include private medical cover, dental insurance and (for a small proportion of the year) travel insurance.

3 Performance-related bonus is stated for the financial year in which it is earned. More details on the bonus framework are given in the relevant section below.

4 Pension is shown as the amounts paid by the employer to defined contribution pension schemes, including any 'matching' contributions made by FSCS, and cash in lieu of pension. Other details are given on page 66 in 'Directors' pension entitlements'.

5 By arrangement and agreement with Paul Stockton's employer, Mr Stockton does not receive a Board fee. Instead, the normal annual fee of £24,500 for non-executive directors, together with the £5,000 a year additional fee payable to the Chairman of the Audit Committee, is invoiced by, and paid to, his employer. The invoiced amounts include VAT, so the annual amount payable for Mr Stockton's non-executive directorship of FSCS for 2016/17 was £35,400 (2015/16: £34,400). No part of this benefit passes to Mr Stockton.

6 This section of the table shows the relationship between the remuneration of the highest paid director and the median remuneration of the organisation's workforce. The banded remuneration of the highest paid director in 2016/17 was £290,000–£295,000 (2015/16: £285,000–£290,000). This was 5.9 times (2015/16: 6.3 times) the median remuneration of the workforce, which was £49,434 (2015/16: £45,590). For this purpose, total remuneration includes salary, bonus and taxable benefits. It does not include pension contributions or cash in lieu of pension. Full details of the remuneration of the highest paid director are given on page 66 under 'Highest paid director' and in Note 10 to the financial statements.

Highest paid director

Audited with the notes to the financial statements

The highest paid director in 2016/17 and 2015/16 was the Chief Executive who received aggregate remuneration of £292,315, comprising basic salary of £259,433, bonus of £32,429, and other emoluments of £452 (2016: £289,227, comprising basic salary of £256,865, bonus of £32,108 and other emoluments of £254). Contributions to a money purchase arrangement under FSCS's pension scheme, plus payments for cash in lieu of pension, have been made totalling £22,786 (2016: £38,102). The Chief Executive did not receive additional remuneration for his role as director.

Directors' fees and salaries

Non-executive directors

The current non-executive director fees, including those of the Chairman, were set in April 2011 and have not changed since.

The fees paid or payable to the Chairman in 2016/17 were set at £75,000 a year (2015/16: £75,000), and fees paid or payable to other independent non-executive directors or their employers were set at £24,500 a year (2015/16: £24,500). Additional fees paid or payable to the chairs of the Audit Committee, Risk Committee and Remuneration and Human Resources Committee, or their employers, were set at £5,000 a year (2015/16: £5,000). The Chairman of the Board was also the Chairman of the Nomination and Governance Committee but does not receive an additional fee for this role. Similarly, an additional fee is not payable to the Deputy Chairman and Senior Independent Director for these roles.

Executive directors

The Remuneration and Human Resources Committee has applied certain principles when reviewing executive remuneration.

First, the salaries of executive directors should be set on the same basis as for other staff and should be subject to the same affordability constraint. This means the pay of executive directors should not be allowed to grow in aggregate faster than the underlying growth in the FSCS pay bill generally. Pay growth for the coming year was set at 1 per cent.

Second, the growth in the salaries of individual executive directors should be set with regard to external benchmarks for equivalent roles. For this purpose, FSCS regards the median salary for equivalent roles as the appropriate benchmark. This is to ensure that, broadly, FSCS matches market rates in order to motivate and retain, but not necessarily to pay significantly more or less generously than the market.

The salaries of executive directors were reviewed and set in line with the above principles and by reference to performance assessments and benchmark data. Salaries for executive directors were subject to a market pay review by external consultants in 2016/17. This review involved collecting pay data with the aim of helping to set pay rates at the appropriate level.

Performance-related bonus

Audited section

Executive directors were eligible to be considered for a performance-related bonus. These bonuses are not available to non-executive directors.

The key principle underpinning the bonus system is that bonuses should be non-consolidated performance awards reflecting the contribution of the executive director concerned to the performance of FSCS as a whole. Objectives are set for each executive director, and include an element of strategic objectives linked to the performance of the organisation as a whole. These are measured and reviewed during the year and at year-end along with other aspects of individual performance. Bonuses are capped at 20 per cent of basic salary.

Directors' pension entitlements

Audited section

During the year, one director (2015/16: one) had a prospective entitlement to a defined benefit pension, with an attaching money purchase augmentation as well as accruing retirement benefits under the money purchase pension scheme. Three additional directors (2015/16: three) also accrued retirement benefits during the year under the money purchase pension scheme only. The independent non-executive directors are not entitled to an occupational pension funded by FSCS.

The executive directors in post during the year were members of the defined contribution (money purchase) pension scheme, on the same terms as for other employees. FSCS makes a contribution equal to six per cent of basic salary, which

Name of director	Normal retirement date (age 60)	Accrued pension at 31 March 2017 £'000	Real increase in pension £'000	CETV at 31 March 2017 £'000	CETV at 31 March 2016 £'000	Real increase in CETV £'000
Alex Kuczynski	08/07/2025	31	0	1,195	1,000	185

increases to 8 per cent after two years of service and 10 per cent after five years' service. Employees may contribute to the plan, and FSCS will match this with an employer's contribution up to a maximum of an additional 5 per cent of basic salary.

The defined benefit (final salary) pension scheme closed to future accrual on 30 June 2011. Defined benefit pension entitlements (and money purchase augmentation) accrued for Alex Kuczynski as a result of participating in the defined benefit pension scheme from the date of joining the Pension Scheme on 20 April 1998 to the date the Pension Scheme closed to future accrual on 30 June 2011. The accrued pension is the pension that he is entitled to receive when he reaches pension age, although this increases in line with the Pension Scheme's rules between 31 March 2017 and 8 July 2025 (his normal retirement date). Mr Kuczynski may elect to retire earlier than his normal retirement date but the pension will be subject to an actuarial reduction. As the nature of these defined benefit pension rights differs from retirement benefits accruing in a defined contribution scheme (including those from his money purchase uplift), further details are given in the table above.

A cash equivalent transfer value (CETV) is the actuarially assessed capitalised value of the defined benefit pension scheme benefits accrued by a member at a particular point in time. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement if the member chooses to leave a scheme and transfer their accrued benefits. The 'Real increase in CETV' reflects the change in CETV using actuarial factors based on market conditions at the start and end of the year. The 'Real increase in CETV' is net of the increase in accrued pension due to inflation.

Other benefits

Executive directors are entitled to receive other benefits. Some of these are taxable benefits and are detailed in the Directors' remuneration table on pages 64–65. Pension benefits are described on page 66 in 'Directors' pension entitlements'. Other benefits available to executive directors, in common with other employees, include private medical cover, dental insurance, travel insurance, life assurance, flexible working, flu vaccinations, season ticket loans, gym subsidy, childcare vouchers, the cycle-to-work scheme, annual professional subscriptions and access to the employee assistance programme.

Remuneration for executive directors holding other non-executive positions

Executive directors may hold positions in other organisations as non-executive directors, and FSCS decides on a case-by-case basis whether they may retain the remuneration earned from such appointments. No remunerated external non-executive positions are held by any of the executive directors.

Mark Neale
Chief Executive

4 July 2017

Compliance with the UK Corporate Governance Code

FSCS has complied throughout the year with the relevant provisions in the UK Corporate Governance Code (the Code) issued in April 2016, with the following exceptions:

Code provision	FSCS position
B.2.1 (making recommendations for Board appointments) Nomination Committee should lead the process for Board appointments and make recommendations to the Board.	• Joint FSCS/FCA/PRA nomination process • Directors appointed by FCA and PRA (with HM Treasury approval also for Chairman and Chief Executive)
C.2.2 (viability statement) Directors should explain how they have assessed the company's prospects, over what period and why they consider that period to be appropriate.	• Audit Committee concluded, given the nature of FSCS and the way it is funded, that it is not appropriate for FSCS to produce a viability statement under this Code provision
D.1.1 (certain provisions for executive directors' performance-related remuneration) Performance-related remuneration schemes for executive directors should include provisions to enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so.	• Remuneration and Human Resources Committee is continuing its review of FSCS's remuneration and reward structure, to include consideration of this issue
D.2.2 (setting remuneration for the Chairman and Chief Executive) and D.2.3 (remuneration for non-executive directors) Remuneration Committee should have delegated responsibility for setting executive directors' remuneration, and the Board or a committee should determine the remuneration of non-executive directors.	• Remuneration and Human Resources Committee sets the remuneration of all executive directors except that of the Chief Executive, which is set by the Board • FSCS Board cannot set remuneration for its Chairman and non-executive directors – this is done by the FCA and PRA, with appropriate input from FSCS
Section E (relations with shareholders) and other provisions relating to shareholders Provisions relating to the maintenance of a dialogue with shareholders and investors.	• FSCS does not have shareholders, but there is close and regular liaison with key stakeholders, such as levy payers, trade bodies, HM Treasury, the FCA and the PRA

Risk management and internal controls

The Board is responsible for FSCS's risk management and internal control systems and for ensuring their effectiveness. This section:

- reviews the principal risks facing FSCS and how they are managed;
- describes the control environment in which risk management is conducted;
- sets out how FSCS has acted to systematise and embed risk management following a Risk and Control Review in 2016/17; and
- reviews several issues that arose in the last year.

Principal risks

There is a continuing process, described below, for identifying, evaluating and managing the principal risks faced by the company. FSCS faces five principal risks to the delivery of its strategic priorities. Each risk has an established tolerance limit, which is approved by the Board on an annual basis on the advice of the Risk Committee, to guide first line managers in designing and implementing controls which will ensure that FSCS manages each risk within tolerance. Any occurrences of risks materialising outside agreed tolerance levels are reported to the Risk Committee. As of 31 March 2017, responsible managers attested that all of the principal risks had been controlled within tolerance across the year. Subject to the issues discussed below, the profile of the risks has not changed significantly across the year.

FSCS principal risks	Mitigating controls
The risk that FSCS pays the wrong amounts or the wrong people.	• The new claims-handling process for non-deposit claims implemented from May 2015 reduced exposure to the risks of fraud and error by bringing FSCS outsource partners onto the same claims-handling platform as FSCS, by automating processes and systems access and by eliminating paper flows. The design of the new process was subject to internal audit review before, during and after roll-out. An internal audit review of controls over the end-to-end claims-handling process in 2016/17 provided substantial assurance. • Claims are subject to peer review either within the outsource partners or FSCS. All complex investment and life and pensions claims are peer reviewed. • The Quality Assurance (QA) function undertakes 'back-end' checks on a random sample of claims. These checks flag the number and scale of wrong payments. Where wrong payments or other errors are detected, QA follows up direct with the responsible outsource partner.
The risk that FSCS provides a poor service which fails to meet service standards and which damages customer confidence and trust.	• Customer satisfaction is measured and reported on a monthly basis – by the end of 2016/17, satisfaction stood at 76% against a target for the year of 70%. • The time taken to turnaround and decide claims is subject to service standards, and performance against those standards is reported monthly. By the end of 2016/17, 96% of claims were decided within the service level against a target of 90%. • Complaints and telephone calls are monitored and issues arising from them are acted on. • The Board sees reports from the Independent Investigator who looks into handling complaints which cannot be resolved by FSCS's internal complaints process. The Independent Investigator considered two such complaints in 2016/17.

FSCS principal risks	Mitigating controls
The risk that FSCS cannot respond effectively to a major failure or financial crisis.	• FSCS reports to the Risk Committee on both the likelihood of, and its own preparedness for, a wide range of financial failures. • Contingency plans are maintained and regularly updated for failures in all major financial sectors, including deposit, insurance and investment failures. • FSCS undertakes annual exercises with its partners to test its preparedness to implement its contingency plans. • Samples of Single Customer View (SCV) files maintained by deposit takers to facilitate an FSCS payout are reviewed annually by FSCS's Data Team and the results reported to the firms involved and to the regulator. • FSCS undertakes regular disaster-recovery exercises. • FSCS has a borrowing facility with a consortium of banks to ensure that it can meet the cash flow requirements of a seven-day payout in the event of the failure of a bank or building society.
The risk that FSCS does not protect market-sensitive or personal information.	• FSCS has achieved and maintained ISO27001 accreditation of those parts of FSCS involved in the provision of the SCV service to deposit takers. This accreditation was independently reviewed and renewed in October 2016. • An Information Security Management System (ISMS) (see below) has been introduced to provide a coherent set of policies, processes and systems to manage cyber risk. • FSCS systems are regularly subject to penetration testing, including the online portal launched in December 2016. • FSCS maintains and monitors compliance with a clear records management policy and procedures which set standards for the retention of personal data. • FSCS is working on satisfying the requirements of General Data Protection Regulation (GDPR) by May 2018.
The risk that FSCS protection is unknown or not understood.	• FSCS commissions market research quarterly into levels of awareness of deposit protection. The most recent research showed awareness at 78% of the adult population compared with a target of 70%.

Control environment: three lines of defence

FSCS operates a 'three lines of defence' model to support its risk management framework. Under this model, responsibility for risk management is assigned as follows:

- First line: Senior managers are responsible for identifying and managing risks to the objectives for which they are responsible and within the established tolerances approved by the Board. These objectives are underpinned by delegated budgets and by a clear framework of delegated authorities. Responsible managers provide attestations to the Chief Executive at year-end that the risks associated with the objectives delegated to them are identified and managed and that effective controls are in place. In addition, responsible first line managers maintain Scheme-wide policies to manage key risks, including the risk that FSCS fails to comply with statutory obligations. These policies are reviewed annually by the Chief Executive and, where reserved, by the Board.
- Second line: The risk management function maintains a level of independence from the first line, reporting to both senior management and to the Board's Risk Committee. It is responsible for providing oversight and challenge to the first line's day-to-day management, monitoring and reporting of risks. Consistent with this responsibility, the Risk Team maintains a central Risk Register which is derived from local registers maintained by the first line. It also provides a summary Risk Profile to the Executive Team and Risk Committee every quarter, highlighting key risks, changes in the materiality of risks and incidents or breaches. The Risk Committee reports to the Board after each meeting and, as a matter of good practice, the Board itself considers the full Risk Profile at least annually. The work of the Risk Committee is described on page 56. The definition of the second line and the associated responsibilities of the Risk Team have undergone some changes in 2016/17 as a result of the Risk and Control Review (discussed below) but these central responsibilities have remained unchanged throughout the year.
- Third line: The internal audit function is responsible for providing independent assurance to both senior management and to the Risk and Audit committees about the effectiveness of the Scheme's governance, risk management and internal controls. The Audit Committee considers any significant control weaknesses identified in internal audit reviews and the remedial action proposed by management. The Committee also considers updates from internal audit on the progress made by management in implementing remedial actions. The Audit Committee reports to the Board after each meeting. The work of the Committee is described on page 55.

Risk management and internal control systems have been in place throughout the year and up to the date of approval of the Annual Report and Accounts. These are kept under review by the Board and some changes were made during the year as a result of the Risk and Control Review described below.

Risk and Control Review

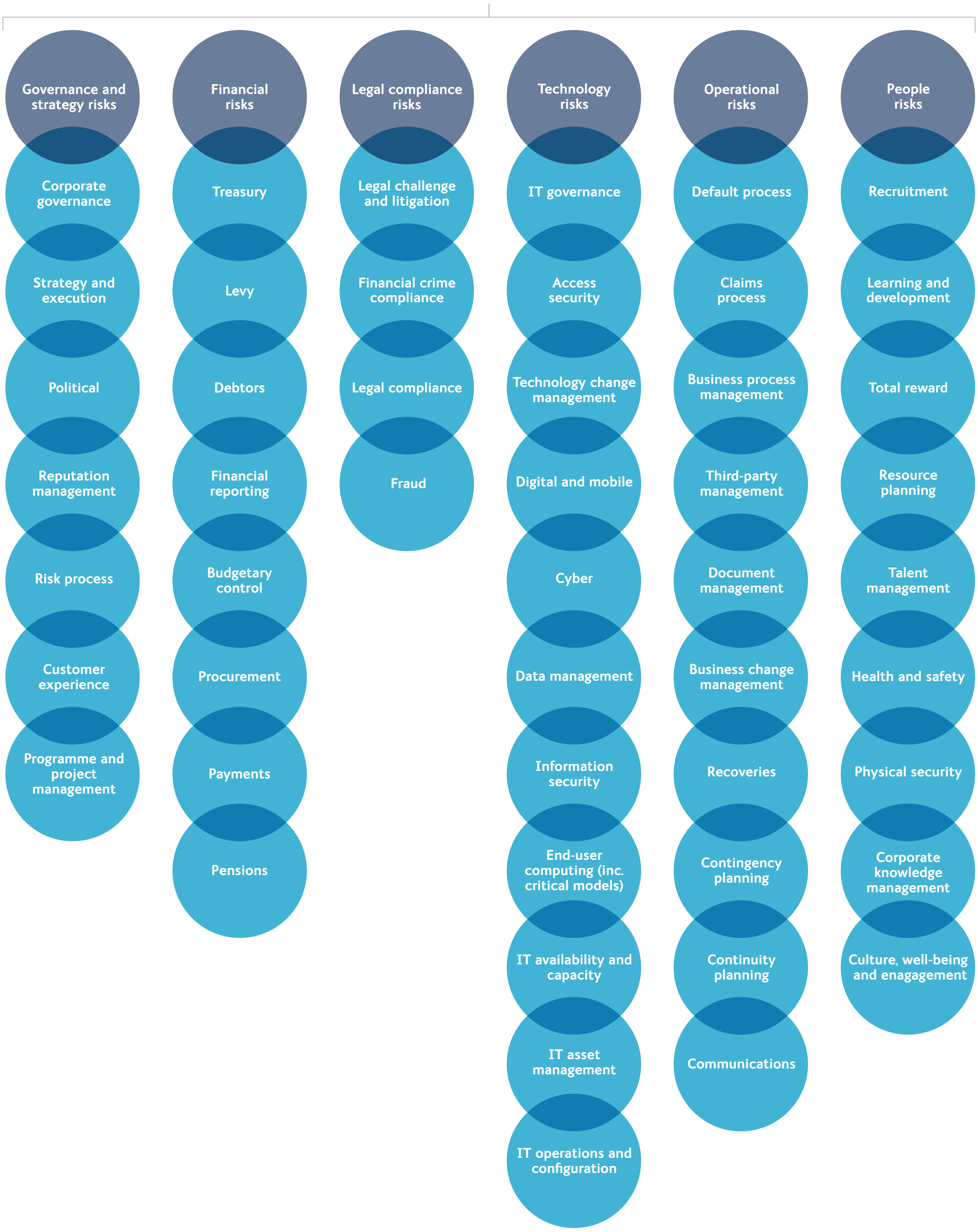
During the course of 2016/17, FSCS undertook a Risk and Control Review with the support of external consultants. The Review was steered by a Board sub-group, including the Chair of the Risk Committee, and progress reported to the Risk Committee and Board. Drawing on external good practice in the financial services sector, the purpose of this Review was to clarify responsibilities, particularly within the second line, and to develop a consistent and well-understood approach to analysing risks and cataloguing the associated controls.

The Review has resulted in a number of important changes to the risk and control regime which are either already in place or in the process of implementation. Specifically:

- Clear statements of risk tolerance have been drawn up for approval by the Board on the recommendation of the Risk Committee in respect of the principal risks facing FSCS, to guide the development of controls.
- The first line's management of risks to the delivery of FSCS's core compensation service has been reinforced by the appointment of a dedicated risk manager within operations.
- The second line of defence has been redefined to consist entirely of the Risk Team, led by a Head of Risk.

FSCS updated its risk framework for identifying, categorising and assessing risks based around a newly defined 'Risk Universe'. The Risk Universe aligns the risks to which FSCS is exposed across 49 risk topics mapped to six high-level risk categories as illustrated below. The risks can also be brigaded and analysed in relation to the principal, strategic risks outlined on pages 69–70.

FSCS Risk Universe



- The definition of risk across FSCS has been systematised by the adoption of a 'Risk Universe' which ensures that risks are analysed against a common functional template (see Risk Universe illustration). Workshops have been held in all FSCS teams to review risks against this functional template. Responsibility for managing those risks then falls to the relevant first line function.
- The controls themselves are to be consistently catalogued as part of a controls library and linked to the risks which they mitigate.

The recommendations of the Review were fully implemented by 31 March 2017.

Issues in 2016/17

Risk of cyber attack

In common with other organisations, one of the principal risks to FSCS centres on a major breach of security which results in the loss of personal data. One manifestation of this could take the form of a cyber attack. Accordingly, the new Chief Operating Officer and Chief Information Officer commissioned an internal audit review of our cyber security which reported in July. In the light of the review, we have developed a comprehensive Information Security Management System (ISMS) which brings together all the standards and policies needed to manage information security and, as part of that, the risk of cyber attack. We have also taken specific actions to reduce FSCS's vulnerability to the cyber threats identified in the review. These include: the recruitment of a security analyst who is now in post; the implementation of safeguards against a denial of service attack; and thorough penetration testing of our online portal.

General insurance failures

The failure of Enterprise Insurance Company PLC and Gable Insurance AG in 2016 has highlighted risks to FSCS's ability to respond effectively to major insurance failures, particularly where firms are based overseas and operate in the UK through a network of brokers and sub-brokers. These risks arise from difficulties in gaining access to reliable data about policyholders and reliance on the co-operation of the insolvency practitioner and of brokers and sub-brokers in cleaning up data and facilitating, where feasible, the provision of new insurance on behalf of policyholders. In response, the Executive has undertaken a full review of FSCS's insurance process to clarify our objectives and accountabilities and, in the light of this clarification, to redefine risks and associated controls.

Quality Assurance

The back-end checks on the accuracy of FSCS's decisions on claims provide an important control of the risk of wrong payments. Accordingly, the Executive has refocused QA during 2016/17 exclusively on the quality and accuracy of the compensation service. The Executive has also asked QA to pay more attention in future to the quality of data inputs following a limited issue in relation to the complex Arch Cru claims. QA draws samples of claims which are designed to ensure that its findings have a 95 per cent chance of being within plus or minus five percentage points of the true value.

GOVERNANCE REPORT
09 DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2017

The directors of the Financial Services Compensation Scheme Limited (FSCS) present their report, together with the audited financial statements of FSCS on pages 87–118 for the year ended 31 March 2017

The directors have chosen to prepare these financial statements in accordance with International Financial Reporting Standards (IFRS). This has been done to enhance the quality of the financial information with the aim of making the financial statements easier to compare and understand internationally and to increase transparency.

The directors

The directors of the company in office during the year, are independent non-executive directors unless stated, and were as follows:

Mark Neale
Chief Executive and
Executive Director
appointed 4 May 2010

Aleksander (Alex) Kuczynski
Executive Director
appointed 1 February 2010

Kathryn Sherratt
Executive Director
appointed 15 December 2015

James (Jimmy) Barber
Executive Director
appointed 4 January 2016

Margaret (Liz) Barclay
resigned 30 June 2017

Caroline (Jayne) Nickalls
resigned 30 June 2017

Robert (Paul) Stockton
appointed 1 December 2011

David Weymouth
resigned 31 December 2016

Lawrence Churchill
Chairman
appointed 1 April 2012

Marian Glen
appointed 1 February 2013

Charles McKenna
appointed 1 February 2013

Mark Adams
appointed 1 June 2015

Directors' remuneration

Details of directors' remuneration are shown in the Directors' Remuneration Report and in Note 10 to the financial statements, 'Directors' remuneration'.

Directors' indemnity and insurance

FSCS maintains insurance to indemnify itself, its directors and its officers against claims arising from its operations. The company has granted qualifying third-party indemnities (as defined in the Companies Act 2006) to its directors in relation to acts or omissions arising in the ordinary course of their duties. These were in force at the date of approval of this report.

Statement of disclosure of information to auditors

Each of the persons who is a director at the date of this report confirms that:

(a) so far as the director is aware, there is no relevant audit information of which the company's auditors are unaware; and

(b) he/she has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information.

Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law, the directors have prepared the financial statements in accordance with IFRS as adopted by the European Union and those parts of the Companies Act 2006 applicable to companies reporting under IFRS. Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the income or expenditure of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable International Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Corporate governance and financial risk management

A statement of corporate governance, including financial risk management and principal risks and uncertainties, is contained in Section 8. Information on the use of financial instruments by the company is disclosed in Note 16 to the financial statements. In particular the company's exposure to credit risk, liquidity risk and interest rate risk are separately disclosed in that note.

Going concern

The directors are satisfied that FSCS is in a position to meet its obligations as they fall due. As such, FSCS is a going concern and it is appropriate that these financial statements are prepared under the going concern basis.

Independent auditors

Under the Financial Services Act 2012, the Comptroller and Auditor General is the statutory auditor of the FSCS.

The Strategic & Performance, Governance and the Directors Reports were approved by the Board on 16 May 2017 and signed on its behalf by:

Mark Neale
Chief Executive
4 July 2017

FINANCIAL STATEMENTS
10 AUDITORS' REPORT

The Certificate and Report of the Comptroller and Auditor General to the Houses of Parliament

Opinion on financial statements
In my opinion:

- the financial statements give a true and fair view of the state of the Financial Services Compensation Scheme Limited's (FSCS's) affairs as at 31 March 2017 and of the result for the year then ended;
- the financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- the financial statements have been prepared in accordance with the Companies Act 2006 and HM Treasury directions issued under the Financial Services and Markets Act 2000.

Opinion on regularity
In my opinion, in all material respects the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Basis of opinions
I certify that I have audited the financial statements of FSCS for the year ended 31 March 2017 under the Financial Services and Markets Act 2000. The financial statements comprise: the Statements of Comprehensive Income, Financial Position, and Cash Flows; and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Directors' Remuneration Report that is described in that report as having been audited.

The regularity framework that has been applied is the Companies Act 2006 and the articles of association of FSCS, the Financial Services and Markets Act 2000, the Financial Services Act 2012 and the Financial Services (Banking Reform) Act 2013, and HM Treasury authorities to the extent they are applicable to FSCS.

Overview of my audit approach
Risks significant to my audit
I consider the following areas of particular audit focus to be those areas that had the greatest effect on my overall audit strategy, the allocation of resources in my audit and directing the efforts of the audit team in the current year. They are similar to areas of focus in the previous year. The only differences are:

- In 2015/16 my audit additionally focused on the 'Connect' IT programme which FSCS had implemented that year; and
- My response to the risks around completeness and valuation of recovery receivables paid particular attention to receivables then due from two Icelandic banks. These have now been received.

I have also set out how my audit addressed these specific areas in order to support the opinion on the financial statements as a whole and any comments I make on the results of my procedures should be read in this context.

<table>
<tr><th>Risk</th><th>My response</th></tr>
<tr><td>Completeness and valuation of recovery receivables
FSCS recovers funds from the administrators of failed firms' estates to offset compensation that has been paid out to its customers.

In line with the accounting standards, an asset must be recognised when there is a realistic expectation that such recoveries will be received from such administrators. I identified the valuation of these assets as a risk because there is a significant degree of judgement and uncertainty in estimating their value and recoverability.</td><td>I tested the controls that FSCS had in place to mitigate these risks. In doing so I:

• applied professional scepticism in the assessment of the adequacy of management's review of their accounting estimates and assumptions used in calculating the recovery of receivables at the year-end; and

• reviewed FSCS's accounting papers to its Audit Committee on the valuation of recoveries.

In addition, I tested the completeness of other receivables through, for example, an assessment of the completeness of 2015/16 receivables to evaluate the effectiveness of this control last year. I also performed an assessment of the policies and processes behind receivables recognition.

The results of my testing across these areas were satisfactory and I am comfortable that there is no significant uncertainty regarding the residual balances that FSCS is still to receive.</td></tr>
</table>

Risk	My response
Recoveries from Bradford & Bingley In addition to the amounts due from the administrators of failed firms' estates above, at the reporting date, £15.7bn was due from Bradford & Bingley plc (B&B). On 31 March 2017, HM Treasury sold £11.8bn of B&B's mortgage assets and FSCS were repaid £11bn. FSCS's share of the cash relating to this sale was received in April 2017. The value of the remaining asset is subject to the winding down of underlying mortgage assets and is therefore sensitive to external factors in the wider economy such as interest rate rises and movements in house prices. The holding company of B&B, UK Asset Resolution (UKAR), expects to launch the next phase of the programme of sales in 2017. The intention is to raise sufficient proceeds for B&B to repay the remaining debt to FSCS and, in turn, the corresponding loan from HM Treasury.	I confirmed the sale of B&B assets took place and that, as expected, funds were transferred to HM Treasury after the reporting date. I assessed FSCS's treatment of the amounts due from B&B at 31 March 2017. I confirmed that while the sale of underlying mortgage assets had been completed, FSCS had not received funds by the reporting date. Therefore, the partial repayment of the loan from B&B should not be recognised in the financial statements. I have also reviewed management's assessment of the recoverability of this asset. I agreed that this sale did not impact on the valuation of the asset at 31 March 2017 and that the receivable should be treated as fully recoverable. In addition, I reviewed UKAR's business plan to understand the forecast winding down of the mortgage book and the book's exposure to credit and other risks. This included a scenario with an asset sale of similar value to the one which eventually occurred. Following this work, I am satisfied that the full amount of £15.7bn will be recovered from B&B.
Revenue recognition Under International Standard on Auditing (UK and Ireland) 240, the Auditor's Responsibility Relating to Fraud in Financial Statements, there is a presumed significant risk of material misstatement owing to fraud arising from revenue recognition. FSCS recognises a payable for the surplus levy income received compared to the expenditure incurred during the year resulting in a nil result in the performance statement. My work focused on the continued applicability of FSCS's revenue recognition policy rather than a general risk of income manipulation.	I performed procedures to ensure the circumstances and arrangements in place adequately support FSCS's revenue recognition accounting policy. A key component of this is whether the firms to which refunds are owed remain materially stable year on year. A comparison between the levy payer population for 2015/16 and 2016/17 was performed. This ensured that the population of levy payers remains sufficiently constant to consider surplus funds payable to an identifiable counterparty. I confirmed that the amounts to be returned carried over from the prior year were appropriately subtracted from the current year levy. The results of this testing do not indicate any fraud in FSCS's revenue recognition policy.

In addition to these risks I also assessed whether there was any evidence of fraud due to management override of FSCS's control environment, as required by International Standards on Auditing. My work in this area did not identify any areas of concern.

Application of materiality
I applied the concept of materiality both in planning and performing my audit, and in evaluating the effect of misstatements on my audit and on the financial statements. This approach recognises that financial statements are rarely absolutely correct, and that an audit is designed to provide reasonable, rather than absolute, assurance that the financial statements are free from material misstatement or irregularity. A matter is material if its omission or misstatement would reasonably influence the decisions of users of the financial statements.

Based on my professional judgement, I determined overall materiality for FSCS's financial statements at £82.5m, which is approximately 0.5 per cent of total assets, a benchmark that I consider to be the principal consideration for users in assessing the financial performance of the entity. I have determined that for income and compensation payments, misstatements of a lesser amount than overall materiality could influence the decisions of users of these financial statements because of an increased sensitivity to misstatements in these areas. I have therefore determined that the level to be applied to these components is £8m which is one per cent of the income received by FSCS.

As well as quantitative materiality, there are certain matters that, by their very nature, would influence the decisions of users if not corrected. These included, for example, the Directors' Remuneration Report and the disclosures of exit packages. Assessment of any such misstatements would take into account these qualitative aspects as well as the size of the misstatement.

I applied the same concept of materiality to my audit of regularity. Regularity is the principle that income and expenditure should accord with Parliament's intention, whether this be expressed through the relevant legislation, the relevant delegated authority or other aspects of the framework of authorities relevant to the entity.

I agreed with the Audit Committee that I would report to it all corrected and uncorrected misstatements identified through my audit in excess of £160,000, as well as differences below that threshold that, in my view, warranted reporting on qualitative grounds, including irregular transactions.

There were no unadjusted audit differences.

The scope of my audit

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by me in the course of performing the audit. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income recorded in the financial statements have been applied to the purposes intended by Parliament and the financial transactions recorded in the financial statements conform to the authorities which govern them.

Opinion on other matters

In my opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions made under the Financial Services and Markets Act 2000;
- the information given in the Strategic and Performance Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements and these reports have been prepared in accordance with the applicable legal requirements; and
- in light of the knowledge and understanding of the company and its environment obtained in the course of the audit, I have not identified any material misstatements in the Strategic and Performance Report and Directors' Report.

Matters on which I am required to report by exception

Adequacy of accounting records and explanations received

I report to you if, in my opinion:

- adequate accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records and returns; or
- I have not received all the information and explanations I require for my audit.

I have nothing to report in respect of these matters.

Consistency of information in the Annual Report

Under the International Standards on Auditing (UK and Ireland), I am required to report to you if, in my opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, my knowledge of FSCS acquired in the course of performing our audit; or
- otherwise misleading.

In particular, I am required to consider whether I have identified any inconsistencies between my knowledge acquired during the audit and the directors' statement that they consider that the Annual Report is fair, balanced and understandable and whether the Annual Report appropriately discloses those matters that we communicated to the Audit Committee and which I consider should have been disclosed.

I confirm that I have not identified any such inconsistencies or misleading statements.

I have nothing material to add, or to draw attention to, on these matters.

Respective responsibilities of the directors and auditor

As explained more fully in the statement of directors' responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Financial Services and Markets Act 2000. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Report

I have no further observations to make on these financial statements.

Sir Amyas C E Morse
Comptroller and Auditor General
National Audit Office
157–197 Buckingham Palace Road
Victoria
London SW1W 9SP

7 July 2017

11 **FINANCIAL STATEMENTS**
FOR THE YEAR ENDED 31 MARCH 2017

Statement of comprehensive income

	Note	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Income:			
Levy income in respect of compensation costs		244,900	208,089
Other levy income		374,391	400,599
Total levy income	*4*	619,291	608,688
Recoveries	*5*	130,362	62,780
Total income		749,653	671,468
Expenditure:			
Compensation costs	*6*	(375,262)	(270,868)
Administrative expenses	*8*	(67,909)	(65,969)
Interest payable	*14*	(306,246)	(336,724)
Net interest on the net defined benefit obligation	*20*	(113)	(226)
Total expenditure		(749,530)	(673,787)
Surplus/(deficit) before tax		**123**	**(2,319)**
Surplus/(deficit) after tax		**123**	**(2,319)**
Other comprehensive income			
Remeasurements on defined benefit pension scheme	*20*	(123)	2,319
Total comprehensive result for the year		–	–

All of FSCS's operations are continuing.

A statement of changes in equity has not been presented as there were no equity balances brought forward or any changes in equity balances during the year.

FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2017

Statement of financial position

	Note	2017 £'000	2016 £'000
ASSETS			
Non-current assets			
Property, plant and equipment		876	928
Other non-current financial assets	11	4,756,971	15,794,947
		4,757,847	**15,795,875**
Current assets			
Trade and other receivables	11	11,432,155	382,700
Cash and cash equivalents	12	357,462	343,422
		11,789,617	**726,122**
Total assets		**16,547,464**	**16,521,997**
EQUITY AND LIABILITIES			
Equity			
Reserves		–	–
Total equity		–	–
Non-current liabilities			
Interest bearing loans and borrowings	13	4,677,873	15,654,509
Other non-current financial liabilities	13	10,106	58,448
Provisions	15	257	211
Employee benefit liability	20	2,682	4,350
		4,690,918	**15,717,518**
Current liabilities			
Bank overdraft	12	8,888	6,959
Trade and other payables	13	499,988	412,711
Interest bearing loans and borrowings	13	10,976,636	–
Loan interest payable	14	306,388	336,724
Provisions	15	64,646	48,085
		11,856,546	**804,479**
Total liabilities		**16,547,464**	**16,521,997**
Total equity and liabilities		**16,547,464**	**16,521,997**

The financial statements on pages 87–118 were approved by the Board of Financial Services Compensation Scheme Limited (Registered Number 3943048) on 16 May 2017 and signed on its behalf on 4 July 2017 by:

Lawrence Churchill
Chairman

4 July 2017

The Notes on pages 90–118 form part of these financial statements.

Statement of cash flows

	Note	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Operating activities			
Net cash generated from operations	17	348,922	658,468
Net cash flows from operating activities		**348,922**	**658,468**
Investing activities			
Purchases of property, plant and equipment		(229)	(205)
Net cash flows used in investing activities		**(229)**	**(205)**
Financing activities			
Decrease in loans	14	–	(143,393)
Returns on investments and servicing of finance	14	(336,582)	(397,403)
Net cash flows used in financing activities		**(336,582)**	**(540,796)**
Net increase in cash and cash equivalents		12,111	117,467
Cash and cash equivalents at 1 April	12	336,463	218,996
Net cash and cash equivalents at 31 March	12	**348,574**	**336,463**

The Notes on pages 90–118 form part of these financial statements.

Notes to the financial statements for the year ended 31 March 2017

1 Constitution

Financial Services Compensation Scheme Limited (FSCS) is a company incorporated and domiciled in the United Kingdom under the Companies Act 2006 as a company limited by guarantee. The members of the company are the directors of the company, and liability is limited to an amount not exceeding £1 for each member. FSCS has no share capital and no ultimate controlling party.

FSCS was established as the designated Scheme Manager under Section 212 of the Financial Services and Markets Act 2000. FSCS, as Scheme Manager, operates eight broad funding classes based on identifiable industry sectors – Deposits, Life and Pensions Provision, General Insurance Provision, General Insurance Intermediation, Life and Pensions Intermediation, Investment Provision, Investment Intermediation, and Home Finance Intermediation.

The registered office is 10th Floor, Beaufort House, 15 St Botolph Street, London EC3A 7QU.

2 Accounting policies

BASIS OF PREPARATION

The financial statements have been prepared on a going concern basis in accordance with the Companies Act 2006, International Financial Reporting Standards as adopted by the European Union (IFRS), and the Accounts Direction issued by HM Treasury. The directors are satisfied that FSCS is in a position to meet its obligations as they fall due given its statutory rights to raise levies on Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA) authorised firms. As such, FSCS is a going concern and it is appropriate that these financial statements are prepared under the going concern basis.

Section 218 of the Financial Services and Markets Act (2000) requires us to prepare a statement of the value of each of the funds established by the Financial Services Compensation Scheme (the Scheme Manager). These statements, referred to as the Class Statements, are separate from the statutory financial statements of the Scheme Manager and have not been prepared under the basis of IFRS as adopted by the European Union. The Class Statements are prepared by the Scheme Manager in accordance with the FCA Handbook and the PRA Rulebook. These statements can be found at www.fscs.org.uk.

The principal accounting policies for the Scheme Manager are set out below.

A) REVENUE RECOGNITION

Levies for compensation costs

FSCS recognises levies receivable in respect of compensation costs on an accruals basis to match compensation costs net of recoveries recognised as income during the period. Any excess funds are ultimately repayable to the levy payer (with shortfalls similarly recoverable from the levy payer), by way of a return or a reduction in next year's levy, in accordance with FSCS's funding rules.

Recoveries

Recoveries are recognised when received, or if earlier, on receipt of notification in respect of dividends from insolvency practitioners, or when notified and agreed in respect of other recoveries. Where no notification is received or agreed, recoveries are also recognised when it is probable that the future economic benefits will flow to FSCS and the value can be measured reliably (based on the best information available to the directors). This differs from the treatment in the Class Statements where recoveries are only recognised on receipt or notification.

Other operating income

FSCS recognises levy revenue raised from authorised firms in respect of management fees to cover the administration costs of FSCS when incurred. The management expenses levy is used to fund FSCS's overheads and is split between base costs and specific costs. All firms contribute to the base costs which are the costs of running FSCS and are not dependent on levels of activity. Specific costs are the costs of assessing claims, making payments, and any other costs which can be directly attributable to a particular class.

As the pension deficit due to the defined benefit plan will eventually be funded through future levies on levy paying firms, an asset and accrued levy income in respect of the pension deficit has been recognised in these financial statements.

B) COMPENSATION COSTS

Compensation costs are only recognised when the eligibility and quantum of the claim is known, or for reinstatement cases when fully valued. In most cases, this is when the claim has been assessed and a decision has been made, as before that point the eligibility and quantum of the claim cannot be known.

In the case of deposit defaults, special administration regime (SAR) defaults, and return of premium cases; these do not require an application form or decision to be made by FSCS; therefore, the expenditure is recognised when the firm is declared in default. In addition, compensation costs payable under various Orders (referred to as deemed compensation) are recognised when the firm is declared in default.

C) FINANCIAL INSTRUMENTS

Trade and other receivables

Receivables are recognised in the statement of financial position when FSCS becomes a party to the contractual provisions of the instrument. Receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method. Appropriate allowances for estimated irrecoverable amounts are recognised in the statement of comprehensive income when there is objective evidence that an asset is impaired. The allowance recognised is measured as the difference between an asset's carrying value and the estimated future cash flows deriving from the continued use of that asset, discounted if the effect is material.

FSCS has recognised financial assets in respect of the recoveries receivable from the estates of the 2008/09 banking failures. In accordance with IAS 39 – Financial Instruments: Recognition and Measurement, these financial assets are classified in the 'loans and receivables' category. IAS 39 requires financial assets classified as 'loans and receivables' to be initially measured at fair value and subsequently measured at amortised cost using the effective interest method. On initial measurement, the directors have chosen not to discount the expected future cash flows because doing so would create a difference between the value of the receivable and associated liability to HM Treasury and therefore would not provide a faithful representation of the true economic reality.

Trade and other payables

Payables are recognised in the statement of financial position when FSCS becomes a party to the contractual provisions of the instrument. Payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits and other short-term liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Borrowings

Borrowings are recognised in the statement of financial position when FSCS becomes a party to the contractual provisions of the instrument. Borrowings are measured initially at fair value, net of transaction costs incurred, and subsequently measured at amortised cost using the effective interest method.

Interest is charged to the statement of comprehensive income over the term of the borrowings. Interest accrued within a financial period becomes due and payable in accordance with the terms of the loans.

D) WELCOME FINANCIAL SERVICES LIMITED (WELCOME)

FSCS declared Welcome in default on 2 March 2011. Welcome sold a substantial number of Payment Protection Insurance (PPI) and other insurance policies and its restructuring arrangements provide for it to make payments to FSCS to fund compensation costs and the costs associated with handling claims. Payments made by Welcome to FSCS are ring-fenced and will only be used to pay for costs relating to Welcome. Such payments are shown in the statement of financial position of FSCS as an asset and in 'Trade and other payables (current liabilities)' since any excess payments will ultimately be repaid to Welcome under agreed terms. Compensation costs and recoveries are shown in FSCS's statement of comprehensive income. The costs associated with the handling of claims are shown in FSCS's statement of comprehensive income under administrative expenses and are recovered from Welcome.

E) PROVISIONS, LEGAL CHALLENGES AND COSTS

A provision is recognised in the statement of financial position when there is a legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. No provision is established where a reliable estimate of the obligation cannot be made.

On occasion, legal proceedings are threatened or initiated against or by FSCS. Provision is made for the estimated full cost in respect of any such proceedings where at the end of the year it is more likely than not that there is an obligation which will require an outflow of economic benefit.

F) INTEREST PAYABLE

Loan interest payable is charged to the statement of comprehensive income in the period according to the terms of the loans, as described in Note 14.

G) INTEREST RECEIVABLE

Interest received on cash deposits is credited to the classes in proportion to their relative fund balance.

H) FOREIGN CURRENCIES

Transactions in foreign currencies are recorded at the rate ruling at the start of the month in which the transaction occurred. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rate of exchange ruling at the reporting date. All differences are charged to the classes.

I) THIRD-PARTY ARRANGEMENTS AS AGENT

FSCS works for and makes compensation payments on behalf of third parties, as agent; these are recoverable from such parties. Any amounts so due from third parties are shown in the statement of financial position.

Management expenses incurred in performing work on behalf of third parties are recovered from such parties by FSCS and not allocated to the classes or funded by levy payers.

J) TAXATION

FSCS is only liable to pay corporation tax on investment income. The related tax on interest income is charged to the classes as shown in the statement of fund movements.

K) PENSION SCHEME

FSCS operates both a defined benefit pension scheme (the Pension Scheme) and a money purchase scheme. The aggregate Pension Scheme asset/liability recognised in the statement of financial position is the excess or deficit of the present value of the Pension Scheme's assets over the value of the Pension Scheme's liabilities. The deficit will be funded by future levies. The costs of the money purchase scheme are charged to the statement of comprehensive income as incurred. The pension costs for the defined benefit scheme are accounted for in accordance with IAS 19. Further details are contained in Note 20.

L) CHANGES IN ACCOUNTING POLICY

i. New and amended standards adopted by FSCS:

There were no IFRS or International Financial Reporting Interpretations Committee (IFRIC) interpretations effective for the first time in the financial year beginning on or after 1 April 2016 that have a material impact on the company.

ii. New standards, amendments and interpretations issued but not effective for the financial year beginning on or after 1 April 2016 and not early adopted:

In May 2014, the International Accounting Standards Board issued IFRS 15 'Revenue from Contracts with Customers'. This standard is effective for annual periods beginning on or after 1 January 2018 with early application permitted. IFRS 15 provides a principles-based approach for revenue recognition, and introduces the concept of recognising revenue for obligations as they are satisfied. The standard should be applied retrospectively, with certain practical expedients available. FSCS is currently assessing the impact of IFRS 15 and has not quantified the effect as at the date of the publication of these financial statements.

There are no other IFRS or IFRIC interpretations not yet effective that would be expected to have a material impact on the company.

3 Accounting judgements and key estimation uncertainties

As identified in 'Critical accounting judgements and key estimation uncertainties' on page 50, there are a number of matters of estimation and uncertainty. In applying the accounting policies as set out in Note 2, those uncertainties could impact on the amounts recognised in the financial statements.

The key areas of judgement and uncertainties identified in the financial statements are:

- In preparing these financial statements, a fundamental judgement has been applied to revenue recognition in respect of levy income. Levy income represents fees to which FSCS deemed it was entitled during the financial year, after taking into account costs associated with running the compensation scheme, including compensation costs less recoveries and management expenses incurred. Any surplus or deficit against levy income in the year is therefore held payable or receivable on the statement of financial position as the intention is to return any surplus, by way of a refund or a reduction in next year's levy, or claim any deficit in the following year;
- £15,654,509,000 owed by Bradford & Bingley plc is treated as fully recoverable. This assessment is based on the best information available to the directors at 31 March 2017, including a review of their latest business plan, a review of their published financials, and other published information;
- the value and expected timing of recoveries through dividends from the estates of the 2008/09 banking failures, as explained in Note 11;
- the provision for net costs of the failure of Dunfermline Building Society (DBS), as explained in Note 15; and
- the current valuation of defined benefit pension deficit, as explained in Note 20.

4 Levy income

In FSCS's financial statements, levies are recognised on an accruals basis, taking into account the costs which have been incurred and any recoveries it has made. The table below shows the total of all constituent parts of levy income for the year reported in the statement of comprehensive income (SoCI):

	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Levy income recognised in SoCI		
Levy income in respect of compensation costs	244,900	208,089
Other levy income:		
Levy income in respect of base costs	21,450	18,639
Levy income in respect of specific costs	48,363	48,561
Levy income in respect of loan interest	306,246	336,724
Levy income in respect of pension obligations	(1,668)	(3,325)
	374,391	**400,599**
Total levy income	**619,291**	**608,688**

5 Recoveries income

Recoveries recognised in the statement of comprehensive income is analysed as below:

	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Other defaults	92,180	26,815
2008/09 banking failures	38,182	35,965
	130,362	**62,780**

6 Compensation costs

The table below provides an analysis of the compensation cost by funding class.

Funding class	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
2008/09 banking failures	5	16
Deposits (excluding 2008/09 banking failures)	(3,323)	8,632
General Insurance Provision	154,032	87,586
General Insurance Intermediation	12,399	8,991
Life and Pensions Provision	–	(16)
Life and Pensions Intermediation	104,773	83,810
Investment Provision	8,779	1,637
Investment Intermediation	82,327	77,108
Home Finance Intermediation	16,270	3,104
Total compensation cost	**375,262**	**270,868**

Deposits (excluding 2008/09 banking failures) include a net credit of £5,137,000 in relation to a provision adjustment for Dunfermline Building Society as described in Note 15.

7 Management expenses and interest payable

Management expenses and interest payable incurred by FSCS which were specifically levied to levy payers are shown in the table below by levy class:

	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Deposits	10,798	16,303
General Insurance Provision	4,974	3,851
General Insurance Intermediation	9,247	9,112
Life and Pensions Provision	7	101
Life and Pensions Intermediation	9,410	5,957
Investment Provision	115	199
Investment Intermediation	12,786	12,447
Home Finance Intermediation	1,026	590
Base costs	21,450	18,641
IAS 19 Pension adjustments	(1,904)	(1,232)
Total management expenses	**67,909**	**65,969**
Deposits – interest payable	**306,246**	**336,724**
Total management expenses and interest payable	**374,155**	**402,693**

8 Administrative expenses

	Note	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Staff costs	9	16,067	15,457
IT maintenance costs		4,011	3,195
Outsourcing costs		15,684	14,370
Welcome costs		412	751
Change including IT development costs		9,871	10,998
Depreciation – owned assets		282	205
Press and communications		3,948	4,131
Auditor's remuneration:			
Statutory audit of the financial statements		154	171
Other audit services		–	–
Legal and professional fees		5,437	5,898
Bank charges		5,161	3,704
Operating lease rentals		390	510
Other		6,492	6,579
		67,909	**65,969**

Welcome costs are funded by Welcome Financial Services Limited as part of its restructuring arrangements (see Note 2(d)).

9 Staff costs

	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Wages and salaries, including the executive directors	11,503	10,941
Social security costs	1,417	1,301
Other pension costs	3,147	3,215
	16,067	**15,457**

The employer's pension contributions shown above include the liability for contributions in respect of service during the year.

The average number of employees of FSCS during the year was as follows:

	Year ended 31 March 2017	Year ended 31 March 2016
Average number of employees:		
Executive Team and internal audit	7	6
Operations	102	100
Non-operations	88	87
	197	**193**

Non-operations include Corporate Affairs, Finance, People Team and Facilities.

10 Directors' remuneration

During the year, there was an average of eight independent non-executive directors (2016: eight) and four executive directors (2016: three). As at 31 March 2017, there were seven independent non-executive directors (2016: eight) and four executive directors (2016: four). Total remuneration paid to directors is as follows:

	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Aggregate remuneration	1,297	1,027
Pension contributions	116	108
	1,413	**1,135**

Retirement benefits during the year accrued to one director (2016: one) under FSCS's defined benefit scheme and four under the money purchase scheme (2016: three).

The highest paid director, the Chief Executive (2016: the Chief Executive), received aggregate remuneration of £292,315 (comprising basic salary of £259,433, bonus of £32,429 and other emoluments of £453) (2016: £289,227 (comprising basic salary of £256,865, bonus of £32,108 and other emoluments of £254)). Contributions to a money purchase arrangement under FSCS's pension scheme have been made of £22,786 (2016: £38,102). The Chief Executive did not receive additional remuneration in respect of his role as director.

The fees paid to the Chairman are set at £75,000 per annum (2016: £75,000) and the fees paid to the independent non-executive directors, or their employers, are set at £24,500 per annum (2016: £24,500). Additional fees paid to the chairmen of the Audit Committee, Remuneration and Human Resources Committee, and Risk Committee were set at £5,000 per annum (2016: £5,000). In addition, business related expenses totalling £25,496 (2016: £18,499) were reimbursed to the independent non-executive directors. The Chairman and the other independent non-executive directors are not entitled to a pension funded by FSCS.

11 Receivables

Trade and other receivables: amounts falling due within one year

	Note	31 March 2017 £'000	31 March 2016 £'000
Amounts due from the FCA	*18*	936	1,163
Levies receivable, net of provision:			
General Insurance Provision		252	1,606
General Insurance Intermediation		10	5
Life and Pensions Intermediation		530	864
Investment Provision		47	30
Investment Intermediation		600	344
Home Finance Intermediation		31	32
FCA Retail Pool		22	–
In respect of base costs		38	39
Net amounts due from levy payers in the following classes:			
Deposit		294,322	337,638
Recoveries receivable in respect of other defaults	*13*	125,826	12,892
Recoveries receivable in respect of the 2008/09 banking failures		11,004,340	23,757
Other receivables		409	306
Prepayments		4,792	4,024
		11,432,155	**382,700**

Other non-current financial assets: amounts falling due after more than one year

	Note	31 March 2017 £'000	31 March 2016 £'000
Amounts due from levy payers of the Deposit class in respect of Dunfermline Building Society	15	41,363	46,500
Amounts due from levy payers in respect of pension deficit		2,682	4,350
Recoveries receivable in respect of the 2008/09 banking failures		4,702,820	15,685,649
Recoveries receivable in respect of other defaults	13	10,106	58,448
		4,756,971	**15,794,947**

Following notice served by HM Treasury, FSCS has an obligation to contribute to the costs of resolution of Dunfermline Building Society, plus interest, but after recoveries, which were financed through levies and recoveries in previous years. The remaining balance will be repaid using recoveries already received. A financial asset of £41,363,000 (2016: £46,500,000) has been recognised in respect of amounts due from levy payers in the Deposits class to fund the costs of resolution. This is in line with IAS 37 – Provisions, Contingent Liabilities and Contingent Assets, which states that if some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised as a separate asset, and not as a reduction of the required provision, when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation.

Total recoveries receivable in respect of other defaults of £135,932,000 (2016: £71,340,000) includes £86,558,000 (2016: £60,432,000) which FSCS expects to receive from firms declared in default in the General Insurance Provision class, £5,935,000 (2016: £nil) from firms declared in default in the General Insurance Intermediation class, and £43,439,000 (2016: £10,908,000) from firms declared in default in the Investment Intermediation class. A corresponding amount has been recognised to reflect the amounts payable to the levy payers in respect of recoveries receivable (see Note 13).

Total recoveries receivable of £15,707,160 (2016: £15,709,406,000) relate to the 2008/09 banking defaults, of which £11,004,340,000 (2016: £23,757,000) is shown within amounts falling due with one year and £4,702,820,000 (2016: £15,685,649,000) is shown within amounts falling due after more than one year.

The timing and value of recoveries receivable is estimated based on information available to the directors at 31 March 2017, including insolvency practitioners' statements of estimated outcome, other reports published as part of the various insolvency processes and legal advice on potential recoveries through litigation; however, the timing and final outcome are uncertain.

The movements in recoveries receivable in the statement of financial position is analysed below:

	Receivable at 31 March 2015 £'000	Movements in recoveries receivable £'000	Receivable at 31 March 2016 £'000	Movements in recoveries receivable £'000	Receivable at 31 March 2017 £'000
Current recoveries receivable:					
Other defaults	20,048	(7,156)	12,892	112,934	125,826
2008/09 banking failures	181,629	(157,872)	23,757	10,980,583	11,004,340
Less: amounts held in Icelandic Escrow account	(35,901)	35,901	–	–	–
Non-current recoveries receivable:					
Other defaults	61,645	(3,197)	58,448	(48,342)	10,106
2008/09 banking failures	15,821,703	(136,054)	15,685,649	(10,982,829)	4,702,820
	16,049,124	**(268,378)**	**15,780,746**	**62,346**	**15,843,092**

As at 31 March 2017, Bradford & Bingley plc (B&B) owed FSCS £15,654,509,000 (2016: £15,654,509,000) as a result of FSCS's contribution to the cost of resolution. As B&B did not enter an insolvency process, there is no creditors' committee in which FSCS can participate. While B&B forecasts a full repayment of the FSCS claim, the timing remains uncertain.

On 31 March 2017, UK Asset Resolution (UKAR) confirmed that following an open and competitive process it has agreed to sell two separate asset portfolios comprising performing buy-to-let loans for a total of £11.8bn to Prudential plc and to funds managed by Blackstone. Financial completion by the end of April 2017 enabled loan repayments to HM Treasury of £10.98bn of the £15.65bn FSCS loan. Subject to market conditions and taxpayer value, and in order to repay the remainder of the FSCS loan in full, UKAR expects to launch the next phase of the programme of sales during 2017/18.

On 25 April 2017, £10,976,636,000 was applied in part repayment of FSCS's loan from HM Treasury. This reduced FSCS's borrowings from HM Treasury to £4,677,873,000.

Balances with other government bodies

Amounts falling due within one year	31 March 2017 £'000	31 March 2016 £'000
Balances with other central government bodies	10,976,636	–
Balances with public corporations	936	1,163
Subtotal: intra-government balances	**10,977,572**	**1,163**
Balances with bodies external to government	454,583	381,537
Total receivables	**11,432,155**	**382,700**

Amounts falling due after more than one year	31 March 2017 £'000	31 March 2016 £'000
Balances with other central government bodies	4,677,873	15,654,509
Subtotal: intra-government balances	**4,677,873**	**15,654,509**
Balances with bodies external to government	79,098	140,438
Total receivables	**4,756,971**	**15,794,947**

12 Cash and cash equivalents, overdraft, facilities and class borrowings

As at 31 March 2017, FSCS had bank facilities of £1,320m, comprising a 364-day sterling revolving credit facility of £1,300m expiring on 20 March 2018, and an overdraft facility of £20m. Any drawdown of the revolving credit facility is subject to Board approval.

	31 March 2017 £'000	31 March 2016 £'000
Cash at bank	357,462	343,422
	357,462	**343,422**
Bank overdraft	(8,888)	(6,959)
	348,574	**336,463**

Cash at bank includes £8,320,000 (2016: £18,630,000) received from Welcome Financial Services Limited referred to in Note 2(d). This sum is ring-fenced and can only be used to pay costs relating to Welcome.

The recast Deposit Guarantee Schemes Directive requires FSCS to have ex-ante funding of at least 0.8 per cent of the amount of covered deposits of its members (to be built up by 2024). The Government confirmed its intention to use the existing bank levy to meet this funding requirement. FSCS will access funds from HM Treasury, through the National Loans Fund or any other appropriate source. The amount of the borrowing facility available to FSCS is determined by HM Treasury. As at 31 March 2017, this facility was not utilised. Any amounts drawn from this facility will be replenished by means of FSCS levies on the Deposits class in subsequent years.

13 Payables

Trade and other payables: amounts falling due within one year

	Note	31 March 2017 £'000	31 March 2016 £'000
Compensation payable		592	671
Net amounts held on behalf of levy payers:			
General Insurance Provision		47,938	50,257
General Insurance Intermediation		5,001	12,264
Life and Pensions Provision		181	187
Life and Pensions Intermediation		54,561	39,718
Investment Provision		7,357	14,251
Investment Intermediation		20,522	64,307
Home Finance Intermediation		4,447	1,003
FCA Retail Pool		22	–
Social security and other taxes		409	379
Due to claimants and/or Welcome		6,105	16,865
Accruals		7,846	9,132
Deferred income in respect of base costs		3,179	2,569
Deferred income in respect of Independent Insurance		2,900	4,580
Amounts due to HM Treasury	*18*	1,104	9,087
Loans	*14*	10,976,636	–
Net amounts due to levy payers in respect of recoveries receivable	*11*	125,826	12,892
Amounts due to levy payers of the Deposit class in respect of the 2008/09 banking failures		209,728	171,549
Other payables		2,270	3,000
		11,476,624	**412,711**

Non-current liabilities: amounts falling due after more than one year

	Note	31 March 2017 £'000	31 March 2016 £'000
Amounts due to HM Treasury:			
Loans	*14*	4,677,873	15,654,509
Net amounts due to levy payers in respect of recoveries receivable	*11*	10,106	58,448
		4,687,979	**15,712,957**

The £1,104,000 (2016: £9,087,000) due to HM Treasury includes an amount of £1,104,000 (2016: £3,125,000) that relates to loans drawn down in advance of compensation payments.

The £6,105,000 (2016: £16,865,000) due to claimants and/or Welcome relates to payments received from Welcome. As explained in accounting policies (Note 2(d)), payments from Welcome are only used to pay compensation and other costs relating to Welcome and any excess amount will ultimately be repaid to Welcome.

The £209,728,000 (2016: £171,549,000) due to levy payers of the Deposits class in respect of the 2008/09 banking failures represents the current fund balance of that class after taking into account the future recoveries FSCS expects to receive from the estates of those firms declared in default (the timing and final outcome is uncertain). Once the final outcome is known and the recoveries have been received, any excess funds will be repayable to the levy payers, by way of a return or a reduction in future years' levy, in accordance with FSCS's funding rules.

Balances with other government bodies

Amounts falling due within one year	31 March 2017 £'000	31 March 2016 £'000
Balances with other central government bodies	10,978,149	9,466
Subtotal: intra-government balances	**10,978,149**	**9,466**
Balances with bodies external to government	498,475	403,245
Total payables	**11,476,624**	**412,711**

Amounts falling due after more than one year	31 March 2017 £'000	31 March 2016 £'000
Balances with other central government bodies	4,677,873	15,654,509
Subtotal: intra-government balances	**4,677,873**	**15,654,509**
Balances with bodies external to government	10,106	58,448
Total payables	**4,687,979**	**15,712,957**

14 Loans

As a result of the 2008/09 banking failures, various arrangements were made during 2008/09 to obtain unsecured loans from HM Treasury and the Bank of England. The facilities with the Bank of England were subsequently refinanced to cover accumulated interest and principal by HM Treasury. Details of loans with HM Treasury are:

Loans

	Principal outstanding as at 31 March 2016 £'000	Drawdown from (and repayment to) HM Treasury £'000	Recoveries £'000	Compensation payments on behalf of HM Treasury £'000	Principal outstanding as at 31 March 2017 £'000
Loan in respect of:					
Bradford & Bingley plc	15,654,509	–	–	–	15,654,509
	15,654,509	–	–	–	**15,654,509**

Loan interest payable

	Principal outstanding as at 31 March 2017 £'000	Interest outstanding as at 31 March 2017 £'000	Interest outstanding as at 31 March 2016 £'000
Loan in respect of:			
Bradford & Bingley plc	15,654,509	306,388	335,227
Kaupthing Singer & Friedlander Limited	–	–	1,497
	15,654,509	**306,388**	**336,724**

The loan interest of £306,388,000 is recoverable from levy payers in the Deposits class by way of a compensation costs levy, and is payable to HM Treasury on 1 October 2017. The interest payable of £306,246,000 shown in the statement of comprehensive income includes a reduction of £142,000 as a result of an over accrual made in 2015/16.

PRINCIPAL TERMS AND CONDITIONS

FSCS now only has a loan facility agreed with HM Treasury for the Bradford & Bingley default. The outstanding principal under this facility is repayable through recoveries from Bradford & Bingley and levies on levy paying firms. FSCS and HM Treasury had previously agreed that the period of the loan would reflect the expected timetable to realise assets from Bradford & Bingley. The loan has a target repayment date of 29 February 2024. Under the loan facilities agreed in 2012, FSCS and HM Treasury review the interest rates and target repayment dates every three years in light of market conditions and of actual repayments from the estates of a number of failed banks to which the loans then in place related.

Following announcements by HM Treasury and UK Asset Resolution on 31 March 2017, £11bn from Bradford & Bingley on 25 April 2017 was applied in part repayment of FSCS's loan from HM Treasury. In line with HM Treasury's update at Spring Budget 2017 and the Office for Budget Responsibility's March forecast, we anticipate that sales of remaining mortgage assets will be initiated in 2017/18 and that the remaining loan will be paid in full.

INTEREST

Under the original terms of the refinanced loans, interest accrued within a financial year (Interest Accrual Period) becomes due and payable six months after the last day of the Interest Accrual Period (being 1 October), and is calculated using 12-month LIBOR plus 100 basis points, adjusted monthly. Following a review of the terms and in light of market conditions, the margin on the rate of interest payable for loans outstanding was increased and is calculated at 12-month LIBOR plus 111 basis points, effective from 1 April 2015. This rate will be subject to a floor equal to HM Treasury's own cost of borrowing as represented by the rate published by the Debt Management Office for borrowing of an equivalent duration. There will be an annual cap on the amount of interest the industry will have to pay through FSCS levies. This cap will be set on the advice of the PRA and takes into account what the deposit-taking sector can afford, having regard to other FSCS and regulatory commitments. Any interest charges exceeding the annual cap will be capitalised and repaid from levies on deposit takers.

The interest figure as shown in the table opposite is the interest accrued on the principal.

15 Provisions

	As at 31 March 2016 £'000	Change in the year £'000	Utilised in the year £'000	Unwinding of discount £'000	As at 31 March 2017 £'000
Compensation cost	1,585	22,923	(1,225)	–	23,283
Dunfermline	46,500	(5,644)		507	41,363
Other	211	46	–	–	257
Total provisions	**48,296**	**17,325**	**(1,225)**	**507**	**64,903**
Current	48,085	17,279	(1,225)	507	64,646
Non-current	211	46	–	–	257
	48,296	**17,325**	**(1,225)**	**507**	**64,903**

COMPENSATION COST PROVISION

Compensation costs include £23,283,000 estimated for return of funds and return of premiums. This takes into account our best estimate of the most likely number of claims FSCS expects to receive and of the amount of these claims using the best information available to the directors at this time.

A provision of £21,490,000 was made for the return of premiums on the failures of Enterprise Insurance Company PLC and Gable Insurance AG during the year. This provision was arrived at using our best estimates from a variety of sources on the likely number of policies FSCS would be paying, multiplied by an average cost per policy based on historical trends. There are significant judgements which had to be made in arriving at this estimate and the final outcome could be significantly different..

DUNFERMLINE BUILDING SOCIETY

Following notice served by HM Treasury, FSCS has an obligation to contribute to the costs of resolution of Dunfermline Building Society (DBS), plus interest, but after recoveries, which will be financed through levies. The FSCS figure for the total amount of the protected deposits, less the valuation of the total FSCS recoveries, in an insolvency counterfactual, will provide the cap on FSCS's contribution. HM Treasury appointed an independent valuer to work out what recoveries FSCS would have received had there been a payout by FSCS to DBS's approximately 260,000 depositors in the event of insolvency. FSCS has decreased the provision in the financial statements for the year ended 31 March 2017 to £41,363,000 (2016: £46,500,000) based on the best information available to the directors at this time. The provision takes account of interim payments totalling £500,000,000 which were made to HM Treasury. The final outcome may be different, however, and the final amounts, once agreed, may result potentially in a significant adjustment to the provision being required. When FSCS is notified by HM Treasury of the final agreed contribution required, the provision will be updated accordingly and the corresponding change made to the compensation cost. This amount will be due to HM Treasury and, as shown in Note 11, recoverable from the levy payers in the Deposits class.

16 Financial risk management

The company's financial risk management policy is disclosed below:

LIQUIDITY RISK

Liquidity risk is the risk that FSCS is unable to meet its payment obligations associated with its financial liabilities as they fall due. FSCS manages its liquidity by carefully monitoring the projected income and expenditure related to its day-to-day business. Each month, FSCS identifies liquidity up to the point when it next expects to levy the majority of fees. FSCS also has available to it for liquidity purposes, £1,320m of facilities, comprising a 364-day sterling revolving credit facility of £1,300m expiring on 20 March 2018, and an overdraft facility of £20m at a fixed margin above bank rate. Any usage of the revolving credit facility would be subject to Board approval.

In the event that FSCS is unable to raise sufficient levies and the facilities mentioned above do not provide adequate funds, FSCS would request a loan from HM Treasury.

INTEREST RATE RISK

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The company's exposure to the risk of changes in market interest rates relates primarily to its long-term debt obligations with floating interest rates (see Note 14).

The interest payable on these loans is dependent on the timing of recoveries obtained from the estates of defaulted firms relating to the 2008/09 banking failures, as these would be used to repay the principal of the HM Treasury loans. The interest payable in any given period is uncertain because the amount and timing of recoveries are uncertain. However, the interest rate risk is ultimately passed onto and absorbed by the levy payers.

The table below summarises the maturity profile of the company's financial liabilities based on contractual undiscounted payments.

As at 31 March 2017	On demand £'000	Less than 3 months £'000	3 to 12 months £'000	1 to 5 years £'000	> 5 years £'000	Total £'000
Interest bearing loans and borrowings	–	10,976,636	–	4,677,873	–	15,654,509
Trade and other payables	–	10,524	489,463	10,106	–	510,093
Loan interest payable	–	–	306,388	160,259	–	466,647
	–	**10,987,160**	**795,851**	**4,848,238**	–	**16,631,249**

As at 31 March 2016	On demand £'000	Less than 3 months £'000	3 to 12 months £'000	1 to 5 years £'000	> 5 years £'000	Total £'000
Interest bearing loans and borrowings	–	–	–	–	15,654,509	15,654,509
Trade and other payables	42	12,468	400,201	58,448	–	471,159
Loan interest payable	–	–	336,724	1,750,675	1,402,394	3,489,793
	42	**12,468**	**736,925**	**1,809,123**	**17,056,903**	**19,615,461**

CREDIT RISK

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with FSCS, resulting in a financial loss to FSCS. FSCS's principal financial assets are cash and cash equivalents, together with levies and recoveries receivables.

FSCS's credit risk falls into three main categories:

i. the collection of levies from the financial services industry: the FCA, which collect the levies on behalf of FSCS, has a strong record in collecting levies;

ii. the placement of those levies as deposits with various counterparties: FSCS only invests with those financial institutions that meet its minimum credit rating as assigned by credit rating agencies; and

iii. recoveries receivable from claims against institutions where FSCS has paid compensation (most often made through an insolvency process).

Any credit risk to FSCS is mitigated by the ability to raise levies on the financial services industry as whole; therefore, any loss due to credit risk will be absorbed by the levy payers.

FSCS considers its most significant credit risk to be the exposure to Bradford & Bingley plc failing to meet its obligations. Refer to Note 11 for further details.

CURRENCY RISK

FSCS is recovering funds from a number of institutions where the recoveries will be in foreign currencies. Changes in the exchange rate for US dollars or euros may affect the value recovered.

FAIR VALUES

The fair values of the financial assets and liabilities are included at the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The following methods and assumptions were used to estimate the fair values:

- Cash and short-term deposits, trade receivables, trade payables, other current assets, and other current liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.
- The fair value of unquoted instruments, loans from HM Treasury and the associated financial assets recoveries receivable in respect of the 2008/09 banking failures is estimated by discounting future cash flows using rates currently available for debt on similar terms, credit risk and remaining maturities.

Set out below is a comparison by class of the carrying amounts and fair values of the company's financial instruments that are carried in the financial statements. Financial assets and financial liabilities which have a fair value that approximately equals their carrying amounts are not disclosed in the table below.

	Carrying amount		Fair values	
	As at 31 March 2017 £'000	As at 31 March 2016 £'000	As at 31 March 2017 £'000	As at 31 March 2016 £'000
Financial assets				
Recoveries receivable in respect of the 2008/09 banking failures	15,707,159	15,709,406	15,618,314	15,357,774
Financial liabilities				
Loans	15,654,509	15,654,509	15,663,855	16,910,467

The difference between the fair values of the recoveries receivable in respect of the 2008/09 banking failures and the loans is predominantly attributable to the present value of loan interest payable. This difference is funded by levy payers in the Deposits class.

17 Reconciliation of the profit/(loss) on ordinary activities before interest and tax to net cash inflow from operating activities

The statement set out below relates cash flows to items shown in the statement of comprehensive income and statement of financial position movements.

	31 March 2017 £'000	31 March 2016 £'000
Surplus on ordinary activities before interest and tax	306,369	334,405
Depreciation	282	205
Loss on disposal	–	–
Decrease/(increase) in receivables	(11,477)	776,418
Increase/(decrease) in payables	38,933	(23,433)
Difference between pension charge and cash contributions	(1,791)	(1,006)
Increase/(decrease) in provisions for liabilities and charges	16,606	(428,121)
Net cash inflow from operating activities	**348,922**	**658,468**

18 Transactions with related parties

During the year, FSCS entered into transactions with the FCA as a related party. The FCA and PRA appoint, and have the right to remove, directors to the Board of FSCS and they establish the rules under which FSCS operates. The FCA and PRA are considered to be related parties but not controlling parties during the year.

During the year, the FCA provided an agency service to FSCS to collect tariff data, issue levy invoices and collect levy monies on its behalf. Levy invoices, net of credit notes, were raised for £730,165,000 (2016: £1,070,734,000) including £335,804,000 raised as a levy for the interest on the loans relating to the 2008/09 banking failures, during July 2016 and £55,701,000 raised as a supplementary levy during February 2017. Collections of £731,555,000 (2016: £1,088,020,000) were received from levy payers. The fee for the agency service was £402,000 (2016: £294,000). During the year, a fee of £116,000 was paid to the FCA for conducting work relating to risk based levies for FSCS..

Overall, payments less receipts of £731,783,000 (2016: £1,088,840,000) were made by the FCA to FSCS, leaving amounts due from the FCA to FSCS at 31 March 2017 of £936,000 (2016: £1,163,000).

During the year, FSCS did not enter into any transactions with the PRA.

HM Treasury is not considered to be a related party or a controlling party. However, in the interest of transparency, full disclosure of the transactions with HM Treasury has been made. These transactions with HM Treasury comprise loan drawdowns and repayments, loan interest fees, loan commitment fees and compensation payments on behalf of HM Treasury.

All loan drawdowns, repayments and interest fees in the year, as well as the balance owed at the year-end, are disclosed in Note 14.

At 31 March 2017, FSCS owed HM Treasury £1,104,000 (2016: £9,087,000) due to loans drawn down in advance of compensation payments of £1,104,000 (2016: £3,125,000) and £nil (2016: £5,962,000) relating to the HM Treasury share of dividends declared or received from insolvent estates (see Note 13).

FSCS has also made a provision at 31 March 2017 of £41,363,000 (2016: £46,500,000) for amounts owed to HM Treasury as a result of FSCS's obligation under the Special Resolution Regime to contribute to the net costs of resolution of Dunfermline Building Society (see Note 15).

19 Contingent liabilities

There are no material contingent liabilities identified at the reporting date.

20 Retirement benefits

FSCS operates both a money purchase scheme and a defined benefit pension scheme (the Pension Scheme), which was closed to new staff and closed to future accrual on 30 June 2011.

MONEY PURCHASE SCHEME

The non-contributory money purchase pension scheme, for permanent and fixed-term contract staff, was set up with effect from 1 February 2001. FSCS makes contributions of six per cent, with incremental increases of two per cent after two years' service, and a further two per cent after five years. The staff member may make voluntary contributions, to which up to a further five per cent will be matched by FSCS.

Amounts paid by FSCS into the money purchase scheme amounted to £1,396,000 and £110,000 was outstanding to be paid at 31 March 2017 (2016: £1,635,000 and £121,000 respectively).

DEFINED BENEFIT PENSION SCHEME WITH MONEY PURCHASE UNDERPIN (HYBRID PENSION SCHEME)

FSCS operates a funded scheme with defined benefits payable that are underpinned by the value of notional money purchase units allocated to members in respect of service prior to 1 April 2002. Assets are held in separate Trustee-administered funds. An actuarial valuation of the pension scheme was carried out as at 1 April 2015. The valuation used the projected unit method and was carried out by Conduent HR Services (the trading name in the UK for Buck Consultants Limited), professionally qualified actuaries.

The Trustees have the primary responsibility for governance of the pension scheme. Benefit payments are from Trustee-administered funds and the Trust is governed by UK regulation. Responsibility for governance of the pension scheme, including investment decisions and contribution rates, lies jointly with the company and the Trustees. The Trustees comprise representatives of FSCS and members in accordance with the Trust Deed and Rules.

Principal actuarial assumptions at the statement of financial position date are:

	31 March 2017 % (p.a.)	31 March 2016 % (p.a.)
Discount rate	2.70	3.30
Salary increase rate	N/A	N/A
Pension increase rate (where increase is based on		
RPI inflation capped at 5% p.a.)	3.20	3.10
Pension increase rate (where increase is based on		
CPI inflation capped at 3% p.a.)	2.10	2.00
RPI inflation assumption	3.35	3.20
CPI inflation assumption	2.35	2.20

The following standard mortality tables published by the Institute and Faculty of Actuaries and projections of future mortality improvements have been used:

Pre- and post-retirement: 105 per cent S2PMA light for males and 78 per cent S2PFA light for females, with future improvements to mortality projected using the Continuous Mortality Investigation (CMI) mortality projections model 2015, with a 1.50 per cent per annum long-term trend rate for males and 1.25 per cent per annum long-term trend rate for females from 2008 onwards, allowing for individual members' year of birth.

For the 31 March 2017 disclosures, 75 per cent of members are assumed to exercise their option to commute the maximum amount of their pension for a Pension Commencement Lump Sum using the cash commutation factors in place as at 31 March 2017. The proportion of members commuting the maximum cash available is also consistent with last year's assumption.

For the 31 March 2017 disclosures, 80 per cent of male and 75 per cent of female members are assumed to have eligible adult dependents of the opposite sex, with males assumed to be three years older than females.

The assumptions were chosen by FSCS, with professional advice.

At 31 March 2017, the pension scheme's assets were invested in a diversified portfolio that consisted primarily of equities.

The fair value of the pension scheme's assets are set out below:

As at 31 March 2017	Quoted £'000	Unquoted £'000	Total £'000
Global equities	17,398	–	17,398
Property	–	1,953	1,953
Index-linked gilts	4,503	–	4,503
UK corporate bonds	2,582	–	2,582
Hedge funds	–	21	21
Diversified growth funds	–	3,229	3,229
Cash and net current assets	619	–	619
Total assets	**25,102**	**5,203**	**30,305**

As at 31 March 2016	Quoted £'000	Unquoted £'000	Total £'000
Global equities	13,090	–	13,090
Property	–	1,888	1,888
Index-linked gilts	3,573	–	3,573
UK corporate bonds	2,391	–	2,391
Hedge funds	–	101	101
Diversified growth funds	–	2,158	2,158
Cash and net current assets	128	–	128
Total assets	**19,182**	**4,147**	**23,329**

The assets as at 31 March 2017 are consistent with the Pension Scheme's investment strategy as set by the Trustees. As the Pension Scheme matures, it is intended to reduce the level of investment risk by moving towards a position that is predominantly liability matching in nature. This involves an asset liability management framework that has been developed to achieve long-term investments that are in line with the obligations under the Pension Scheme. Within this framework, the objective is to match assets to the pension obligations by investing in long-term fixed interest and index-linked securities with maturities that match the benefit payments as they fall due and in the appropriate currency. FSCS actively monitors the duration and the expected yield of the investments that are matching the expected cash flows arising from the pension obligations.

The Pension Scheme does not invest in the sponsor's own financial instruments, including property or other assets owned by the sponsor.

The amounts recognised in the statement of financial position are as follows:

	31 March 2017 £'000	31 March 2016 £'000
Fair value of assets	30,305	23,329
Present value of obligations	(32,987)	(27,679)
Funded status	**(2,682)**	**(4,350)**
Adjustment in accordance with paragraph 64 of IAS 19 (the 'asset ceiling')	–	–
Net defined benefit asset/(obligation)	**(2,682)**	**(4,350)**

Movement in net defined benefit asset/(obligation) over the year	31 March 2017 £'000	31 March 2016 £'000
Net defined benefit asset/(obligation) at beginning of the year	(4,350)	(7,675)
Employer contributions	2,229	1,634
Expense recognised in income statement	(438)	(628)
Remeasurement gain/(loss) recognised in other comprehensive income	(123)	2,319
Net defined benefit asset/(obligation) at end of the year	(2,682)	(4,350)

Changes in effect of the asset ceiling over the year	31 March 2017 £'000	31 March 2016 £'000
Adjustment at beginning of the year	–	(2,816)
Interest income	–	(90)
Change in adjustment in excess of interest	–	2,906
Adjustment at the end of the year	–	–

IFRIC 14 is an interpretation of existing paragraph IAS 19.64, which deals with the level of net pension asset recognisable on a company's balance sheet. IFRIC 14 also requires consideration of minimum funding commitments a company has made to its pension scheme and whether this gives rise to an additional balance sheet liability.

In 2015/16, the Pension Scheme's Definitive Trust Deed and Rules was amended which provides FSCS with an unconditional right to a refund of surplus in the context of IFRIC 14 paragraphs 11(b) and 12. The consequent removal of the asset ceiling adjustment has reduced the net benefit obligation by £2,816,000.

Changes in present value of the defined benefit obligation	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Opening defined benefit obligation	27,679	27,194
Interest cost	895	863
Distributions	(1,139)	(440)
Experience (gains)/losses	–	630
Losses/(gains) on curtailments	–	–
Actuarial (gains)/losses	5,552	(568)
Closing defined benefit obligation	**32,987**	**27,679**

SENSITIVITY ANALYSIS OF THE PENSION SCHEME LIABILITIES

The sensitivity of the principal assumptions used to measure the Pension Scheme liabilities is set out below:

	Change in assumption	Impact on Scheme liabilities £'000
Discount rate reduced by	0.25%	35,263
Discount rate increased by	0.25%	30,897
Inflation and associated pension increases increased by	0.25%	34,796
Inflation and associated pension increases reduced by	0.25%	31,030
Life expectancy decreased by	one year	34,117

DESCRIPTION OF RISKS TO WHICH THE PENSION SCHEME EXPOSES FSCS

If the Pension Scheme assets do not move in line with Pension Scheme liabilities then a deficit may arise. As the Pension Scheme matures, FSCS intends to reduce the level of investment risk by moving towards a position that is predominantly liability matching in nature. The majority of benefits are linked to inflation and so increases in inflation will lead to higher liabilities (although in most cases there are caps in place which protect against extreme inflation). Increases in life expectancy will increase pension scheme liabilities. The inflation-linkage of the benefits also means that inflationary increases result in a higher sensitivity to increases in life expectancy.

Changes in fair value of the Pension Scheme assets	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Opening fair value of assets	23,329	22,335
Contributions paid by employer	2,229	1,634
Interest income	782	727
Return on Scheme assets excluding interest income	5,429	(525)
Distributions	(1,139)	(440)
Administration expenses	(325)	(402)
Closing fair value of assets	**30,305**	**23,329**

Expenses recognised in the income statement	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Administration expenses	325	402
Net interest on the net defined benefit obligation	113	226
Total expense/(income)	**438**	**628**

Remeasurement effects recognised in other comprehensive income	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Return on Pension Scheme assets excluding interest income	5,429	(525)
Experience (losses) arising on the Pension Scheme liabilities	–	(630)
Changes in financial assumptions underlying the present value of the Pension Scheme liabilities	(5,863)	634
Changes in demographic assumptions underlying the present value of the Pension Scheme liabilities	311	(66)
Adjustment in accordance with paragraph 64 of IAS 19 (the 'asset ceiling') in excess of interest	–	2,906
Net actuarial losses recognised in the period	**(123)**	**2,319**

	£'000
Best estimate of employer contributions to be paid over following year	1,920
Expected future benefit payments	
Year ending 31 March 2018	235
Year ending 31 March 2019	251
Year ending 31 March 2020	256
Year ending 31 March 2021	299
Year ending 31 March 2022	542
Five years ending 31 March 2027	3,142

As required by IAS 19, the projected unit method has been used to determine the liabilities.

FSCS has agreed with the Trustees that the funding objective is to ensure the Pension Scheme has sufficient and appropriate assets to cover its technical provisions (which are effectively the liabilities in respect of service already completed) under the Scheme Specific Funding regulations (the pension scheme operates under the Pensions Act 2004 regulatory framework).

The valuation of the Pension Scheme's liabilities for accounting purposes has been carried out at a different date from when the Pension Scheme's last actuarial valuation was carried out to determine the funding position and using some different assumptions. Therefore, the figures quoted in this note are different from those disclosed in the last actuarial valuation report as would usually be expected. The figures set out in this note are calculated according to the requirements of accounting standard IAS 19. Separate calculations will be carried out for the Trustees and possibly the sponsor to monitor and control the funding of the Pension Scheme using assumptions selected by the Trustees.

FSCS estimates the duration of the Pension Scheme liabilities on average to fall due around 25 years.

21 Other disclosures

HM Treasury has issued an Accounts Direction requiring FSCS to disclose the following information:

SICKNESS ABSENCE

FSCS actively promotes the health, safety and well-being of its staff, aware that this helps to boost morale, staff engagement and, in turn, excellent performance. The average number of working days lost to sickness absence during the year to 31 March 2017 was 4.0 days per person (2016: 7.1 days per person).

EXIT PACKAGES

FSCS is required to disclose summary information of the use of exit packages, in accordance with the Accounts Direction issued by HM Treasury. The following table includes exit packages as they relate to all employees, and exit packages are accounted for in full in the year of departure.

Exit package cost band	Number of compulsory redundancies Year ended 31 March 2017	Number of other departures agreed Year ended 31 March 2017	Total number of exit packages by cost band Year ended 31 March 2017	Total number of exit packages by cost band Year ended 31 March 2016
<= £10,000	–	–	–	–
£10,001–£25,000	2	1	3	1
£25,001–£50,000	3	1	4	1
£50,001–£100,000	1	2	3	3
£100,001–£150,000	–	–	–	1
£150,001–£200,000	–	1	1	–
Over £200,001	–	–	–	–
Total number of exit packages by type	**6**	**5**	**11**	**6**
Total resource cost (£'000)	**266**	**336**	**602**	**381**

FSCS is not required to follow the provisions of the Civil Service Compensation Scheme as its principal governance arrangement is with the FCA/PRA. Any FSCS exit packages are approved in line with our own internal procedures.

SPECIAL SEVERANCE PAYMENTS

There were no special severance payments paid out during the year to 31 March 2017 (2016: no special severance payments paid).

LOSSES AND SPECIAL PAYMENTS

Quality Assurance and other checks of compensation payments in relation to Arch Cru funds made subsequent to 31 March 2017 identified errors in calculation made over a four year period to 31 March 2017. Whilst there were no losses or special payments exceeding £300,000 individually or in total in any one year, total overpayments over that period are estimated at £335,000.

By phone on:

0800 678 1100 or

020 7741 4100

Lines are open from 8.30am to 5.30pm (Monday to Friday, excluding public holidays)

By post to:

Financial Services

Compensation Scheme

10th Floor

Beaufort House

15 St Botolph Street

London

EC3A 7QU

Online enquiry form

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