
# Has the FSCS refusal to discuss the use of a product levy as a way of funding given advisers a common cause?

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Last week, there was a round table meeting to discuss how the FSCS would finance their activities. At that meeting, the FSCS management decided to exclude any concept of product levy from their funding review. In so doing, they shut down the only logical solution to their own FSCS funding problem – and stirred up the adviser community who could not comprehend the logic of their stance.

Their solution appears to be to risk-rate adviser firms and charge them accordingly. We will return to the practical problems of this later, but to comprehend the issue you need to understand how the FSCS was created.

FSCS is essentially an extension of the Policyholders Protection Act which was formed to protect Insurance company customers should their product provider fail.

The concept was that the policies of the failed company would be adopted by another insurer, with any shortfall being covered by all the other firms on a pro-rata rate to their share in the market.

This worked because it created a huge client co-operative, where every client paid within their charging structure a small, additional fee, for this cover. Sadly, it was not an explicit charge but it was a charge nonetheless and, most importantly, all the clients could see they contributed towards it.

This had three major benefits. Firstly, the exposure to claims in any one year was limited to the failures in that year. Secondly, insurance companies had access to the client's money, making administration a relatively straightforward process. And thirdly, all firms contributed at a pro-rata rate, so there was no anti-competitive element to the process.

For advisers, the FSCS is a very different beast. In macro terms, every additional year the FSCS exists is an additional year of exposure. This is unending, because of the failure of regulators to recognise the Limitations Act – or Longstop as it is quickly becoming known as.

The FSCS and its predecessors have now been operating since 1984. Advisor firms are, therefore, now exposed to claims dating back thirty years – and that exposure can only increase year-on-year. To put some numbers on this, Gfk and the Heath Report showed that 16 million clients have used the IFA sector in the last thirty years. Each and every one of them could have a potential FSCS claim.

However, only six million clients will take advice this year and, by so doing, they are the ones that will end up paying the FSCS claims. This is due to the drop in adviser numbers and, more importantly, the halving of the client/adviser ratio.

The result is two conflicting trends. Claims can only go up as the years extend, while the clients receiving advice will continue to go down as firms continue to rationalise their client banks. The only way this circle can be squared is for all 16 million clients – past and present – to contribute, which means some form of product levy is required.

Now let us look at the divisive idea of risk-rating FSCS contributors. Remember the quantum remains the same, the number of contributors remain the same (at least initially), but the distribution differs on the basis of "Risk". The difference in "risk" rated firms and "safe" firms would have to be significant to make the idea viable.

And how is the FSCS going to assess Risk? Libertatem's PI Broker informs me that, in complex cases, it takes three people two days to come up with a premium. As those hit by the additional risk charge will be, by definition, that type of adviser, where is the FSCS going to get the talent to do this fairly? It could not use a firm's PI premium because levels of cover vary so much.

So how does a "risk" rated adviser de-risk his exposure? He cannot undo the advice already given. The client may even be delighted with the advice, but if FSCS says you are a risky adviser you will get hit with a significant extra charge in perpetuity.

The risk-rated adviser will, therefore, have two choices. He can continue to trade with high PI and FSCS costs, which will destabilise the firm in the long run and probably result in that firm becoming less competitive. Or he can simply shut down the firm, ideally before any claims come out of the woodwork, and either start up again or retire. Consequently, in the following year, the sector will have less advisory businesses contributing to the ever-increasing FSCS pot and the costs for the "good" firms will go up. This is precisely the opposite of what FAMR wanted to do.

Take this to its logical conclusion and the firms deemed "risky" by FSCS will probably be a short-term phenomenon as they are likely to shut down. But for those of you who think this a good idea, think again.

When a firm shuts down, the administrator does not keep the paperwork for six years (or in perpetuity as the FCA now demands of the sector). Instead, the files are destroyed after six months. This means every ambulance-chaser leaving the PPI arena will zero in on those ex-firms as they no longer exist and cannot, therefore, defend themselves. Similarly, abandoned clients are far more likely to crystalize into claims than those being serviced.

So the surviving firms will see not only FSCS increases created by the macro pressures, but also additional pressures created by risk-rated firms leaving the market resulting in extra claims. That can only lead to a spiral of decline.

The solution has been obvious for the past thirty years. We need a charge on investments introduced through the Independent sector. It should be a transparent charge disclosed to the client through his platform or provider. We should not expect platforms or providers to absorb this charge, just to administer it. In this way we return to the original PPA concept that all potential claimants should pay and FSCS does not become anti-competitive. It may be the only practical solution - but how can we achieve it?

The past 15 years of silent acquiescence has got us nowhere. We are still saddled with an unaccountable regulator. Longstop and the product levy was removed from the table before the FSCS Review even started. Asking nicely simply hasn't worked.

And what is the regulator's downside for refusing these things? Nothing. They know that the current disunited adviser population will not embarrass them in Parliament or in the media. Until those who call the shots face a credible downside, we will not see progress.

**In refusing to even discuss a levy, the FSCS may actually achieve the last thing they would have wanted: A united adviser sector.**

If you join Libertatem, we can start to change the current regime. Through lobbying, persistence, raising awareness and coming up with alternatives, we can effect change. But to achieve this, we need members, courage and energy – and we need them now before it's too late.

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