Fourteenth Report of Session 2022-23

Financial Conduct Authority

Investigation into the British Steel Pension Scheme

Introduction from the Committee

There are two main types of workplace pension, a defined benefit (DB) scheme, which provides a guaranteed income to members in retirement based on how many years they have worked and the salary they have earned, and a defined contribution (DC) scheme, which relies on contributions and investment choices made by each member. The British Steel Pension Scheme (BSPS) was a large DB pension scheme, sponsored by Tata Steel UK, with assets worth approximately £13.3 billion. The scheme was restructured in 2017 and 7,834 members chose to transfer out into a DC scheme. Almost all (95%) of these decisions were informed by independent financial advisers, and at least 46% of the advice provided was found to be unsuitable, causing significant financial detriment. The Financial Conduct Authority regulates over 50,000 financial services firms and is responsible for supervising independent financial advisers, including the estimated 369 firms who advised BSPS members. The FCA also oversees the redress process for consumers when things go wrong, through which the Financial Ombudsman Service resolves complaints between financial services firms and their consumers, and the Financial Services Compensation Scheme (FSCS) pays compensation to consumers in cases where firms have entered insolvency:

Based on a report by the National Audit Office, the Committee took evidence on 27 April 2022 from the Financial Conduct Authority (FCA), the Financial Ombudsman Services (FOS) and the Financial Services Compensation Scheme (FSCS). The Committee published its report on 21 July 2022. This is the FCA's response to the Committee's report.

Relevant reports

- NAO report: Investigation into the British Steel Pension Scheme – Session 2021-22 (HC 1145)
- PAC report: Investigation into the British Steel Pension Scheme – Session 2022-23 (HC 251)

FCA's response to the Committee

The Financial Conduct Authority (FCA) thanks the Committee for their report and accepts there are lessons to learn, both for how we operate as a regulator, and for how the wider pensions regulatory system serves to protect consumers. However, the FCA is concerned the report does not fully acknowledge the ways the FCA has responded since 2017, acting against poorly performing firms and improving the wider defined benefit pension transfer market. For example, in the case of BSPS over £20 million of redress has been paid out by firms due to the action the FCA has taken.

Further updates in line with the Committee's recommendations and a response to some of the wider conclusions of the report is set out in a letter from the Chief Executive of the FCA to the Chair of the Committee, dated 22 September 2022.

1: PAC conclusion: The regulatory system left British Steel Pension Scheme members open to being manipulated and taken advantage of by unscrupulous financial advisers who personally profited from giving bad advice

1: PAC recommendation: The FCA should provide the committee with an update on:

- ***the extent and impact of unsuitable advice on BSPS members; and***
- ***what it has done to prevent a similar case from occurring again, and in particular, changes to its approach to regulating small advice firms***

1.1 The Financial Conduct Authority (FCA) agrees with the Committee's recommendation.

Recommendation Implemented

1.2 An update in line with this recommendation is contained within the letter from the Chief Executive of the FCA to the Chair of the Committee, dated 28 September 2022.

1.3 The FCA shares the significant concerns of steelworkers, MPs and other stakeholders about the levels of unsuitable advice and recognises the harm that this has caused to steelworkers and communities. Over the past year, the FCA has met with over 400 steelworkers, providing support and listening to their concerns. The FCA has also carried out significant work to date to analyse both the extent and the impact of unsuitable advice on steelworkers. This is set out in the FCA's consultation paper (CP 22/6 published in March 2022). Should we go ahead with a redress scheme, the FCA will be happy to update the committee with final unsuitability rates once the scheme closes.

1.4 The Joint Protocol, currently operating between the FCA, the Pensions Regulator (tPR), the Pension Protection Fund (PPF) and the Money and Pensions Service (MaPS), sets a framework for increased communication and information sharing. Since its inception in January 2019, it has facilitated greater joint working and early intervention to address the risk of concentrated and/or significant numbers of members receiving unsuitable advice on DB transfers and/or any associated risks of pension scams or mis-selling that consumers may face. Actions have included issuing joint proactive statements, setting out the concerns and action each organisation will take, as exemplified by the statements associated with the Rolls Royce pension scheme and the P&O pension scheme.

1.5 The FCA's regular data return (discussed under recommendation 2 below) also enables the regulator to proactively monitor trends and engage with firms which are active in the DB market.

2: PAC conclusion: The Financial Conduct Authority has consistently been behind the curve in responding to the catastrophic impact on British Steel Pension Scheme members.

2: PAC recommendation: The FCA should examine what can be done to improve the data and insight that they need to inform a more proactive approach to regulation, and what lessons can be learnt from its response to the COVID-19 pandemic.

2.1 The FCA agrees with the Committee's recommendation.

Recommendation Implemented

2.2 From 2018, the FCA has been collecting more DB pension transfer data from advisory firms across the market to improve its market intelligence and identify individual firms that may be posing a risk to consumers. The FCA's current rules (effective from October 2020) require firms with permission to advise on pension transfers to report a range of key data metrics to the FCA on a half-yearly basis. Risk indicators are triggered from the data entered, which includes detail in relation to volume of business conversion rate, resource levels, income levels and DB business trends. Supervisory review and action is taken where risk indicators are triggered.

2.3 More widely, the FCA has carried out extensive work to implement the recommendations and lessons from the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc (the Gloster Report) and the Independent Review into the FSA and FCA's handling of the Connaught Income Fund Series 1 and connected companies (the Parker Report), as set out in FCA's update to the Treasury Select Committee of December 2021. This includes changes to reinforce the FCA's data capability to get better insights, enabling more effective supervision and enforcement.

2.4 The FCA's work in this area builds on its investment in data capabilities of over £120m over three years from 2019. This has involved creating core data platforms, tools to support data management and advanced analytics, evolving the frontline divisions, and enabling cultural change that underpins transformation, by ensuring ways of working evolve appropriately. For the financial year 2021 to 2022, the FCA's data and technology spend includes further updating and maintaining the FCA's technology infrastructure to ensure the organisation remains operationally resilient and implementing tooling to improve how it collects, stores, and manages data. This also supports the FCA's regulatory goals in relation to authorising and supervising firms. In addition, this funding enables the delivery of longer-term transformational change, such as upgrading the FCA's Financial Services Register over a five-year programme to improve user experience, ensure data quality and prevent harm.

2.5 The FCA will continue to build on the lessons learned from its response to the COVID-19 pandemic. The FCA's Transformation Programme includes reforms to its decision-making and governance so the organisation can respond more quickly to prevent or stop consumer harm. This is exemplified by the actions taken following the FCA's review of the Regulatory Decisions Committee (RDC), including moving some decision making from the RDC to the FCA's senior managers.

2.6 However, the FCA is satisfied that the sort of rapid response used in the context of the COVID-19 pandemic is not viable when seeking to impose a redress scheme on a particular sector, pursuant to the powers we have in section 404 of the Financial Services and Markets Act 2000 (FSMA). The FCA's power in this section is a specific rule-making power which is subject to the FCA being satisfied that the tests provided by Parliament are met before it can make rules. These include the FCA having regard to the approach which would be taken by a court to determine whether firms have committed regulatory breaches, as well as determining whether the losses suffered by consumers are of a type that could be recovered by consumers in legal proceedings. In addition, assuming the section 404 tests are met, Parliament has imposed a duty on the FCA to consult on its proposals for a redress scheme with all relevant stakeholders and to publish its cost-benefit analysis, as the FCA has done in CP 22/6.

3: PAC conclusion: The Financial Conduct Authority has not been sufficiently proactive or timely in using its enforcement powers

3a: PAC recommendation: The FCA should report to the committee on the progress being made on its 30 active enforcement cases, how it is updating its approach to make a clearer distinction about how it enforces against poor conduct and rogue advisers, and how it signals the outcome of its actions to the wider market. The FCA should review whether it has sufficient enforcement powers to deal with bad actors in the financial industry. The Treasury should consider how to address concerns about activity relevant to, but not within, the FCA's remit, for example the actions of introducers in cases such as the BSPS.

3.1 The FCA is able to provide a high-level update on enforcement activity as set out below.

3.2 Enforcement activity related to BSPS is a high priority for the FCA. The FCA currently has c.30 ongoing investigations into firms and individuals relating wholly or partly to BSPS advice. Those investigations are at an advanced stage and five of them have entered either Stage 1 settlement discussions (i.e. a 28 day period within which the subject may agree to the FCA's findings to resolve matters) or the Regulatory Decisions Committee (i.e. a Committee of the FCA Board which takes contested enforcement decisions on behalf of the FCA and operates separately from the rest of the organisation). If a matter is resolved in Stage 1, the FCA can proceed to publish information about it. If, following Stage 1, the subject contests the matter it moves into the Regulatory Decisions Committee or Upper Tribunal process. The timing of those processes is determined by those respective bodies.

3.3 Intervention work carried out by the FCA has also led to 48 firms withdrawing from the defined benefit pension transfer advice market. Interventions made by the FCA have required firms to cease all regulated activities relating to DB pension transfers and have stopped firms providing DB pension transfer advice to BSPS customers.

3.4 The FCA undertakes enforcement investigations where there is evidence that firms or individuals have engaged in serious misconduct. Under the Financial Services and Markets Act 2000 (FSMA), the FCA has an extensive range of disciplinary, criminal and civil powers to take action against those who have failed to meet the required standards. The FCA also keeps an open mind to the misconduct under investigation and, in addition to suitability of advice. Where the FCA sees evidence of other issues like asset stripping, it will take action where appropriate.

3.5 Each of the 30 investigations is complex and has required the analysis of significant volumes of evidence, compelled interviews with key witnesses and the review of customer files. The FCA recognises that the time it takes to properly review evidence and decide whether this provides the legal basis for further action is an understandable source of frustration for those affected, who expect to see action taken.

3.6 It is vital that the FCA investigates thoroughly and looks at all of the available evidence before making conclusions about what, if any, misconduct may have taken place, who is responsible and what sanction is appropriate.

3.7 It is also important for both legal and practical reasons that the FCA's investigations remain confidential until complete. This is so we do not prejudice their outcome, which could make imposing sanctions far more difficult.

3.8 Further information on cases before the Upper Tribunal and Courts, and the FCA's wider enforcement work are set out in a letter from the Chief Executive of the FCA to the Chair of the Committee, dated 28 September 2022.

3b: PAC recommendation: The Treasury should consider how to address concerns about activity relevant to, but not within, the FCA's remit, for example the actions of introducers in cases such as the BSPS.

3.9 The government disagrees with the Committee's recommendation.

3.10 It does, however, recognise the importance of the recommendation and welcomes the Committee's view on the need for effective mechanisms to consider and, where appropriate, address concerns about activity that is not within the FCA's regulatory perimeter. The government has concluded that, on balance, the key mechanisms that currently exist are appropriate to address the types of concern highlighted by the Committee. These mechanisms are described below.

3.11 The FCA's remit, also known as the regulatory perimeter, is the boundary between what the FCA does and does not regulate. Where the Treasury considers that an activity should be regulated, it will typically engage with the FCA to bring those activities within the perimeter. The costs and benefits of bringing activities into the regulatory perimeter can be finely balanced, which is why the government is committed to regulating only where there is a clear case for doing so.

3.12 To support consumers' understanding of the perimeter and explain the work being undertaken to address perimeter issues, the FCA has published an Annual Perimeter Report since 2019. Where there are concerns about activities which are relevant to, but not within the FCA's remit, there are existing arrangements for engagement between the Treasury and the FCA on these issues, including an Annual Perimeter Meeting between the FCA CEO and the relevant Treasury minister.

3.13 Firms that are authorised to conduct regulated activities may also conduct unregulated activities. Whilst being an introducer does not require FCA-authorisation, many introducers in the case of BSPS were authorised and regulated by the FCA to conduct other regulated activities. Regulated introducers tend to be financial advisers and other regulated firms that do not have the necessary FCA permission to give DB transfer advice. These firms need to "refer" their clients to a firm with the appropriate DB transfer permissions should their clients want advice on their DB scheme. Unregulated introducers are firms that are not authorised by the FCA.

3.14 Where authorised firms are performing unregulated activities alongside their regulated activities, the FCA already has the ability to take action in relation to those unregulated activities. This is because certain FCA rules, including its Principles for Businesses, apply to an authorised firm's business as a whole, not just its regulated activities. In relation to the concerns raised by the Committee, this means the FCA is already able to take action against regulated introducers, even though being an introducer is not a regulated activity.

3.15 The FCA has recently taken steps to enhance its approach to unregulated activities performed by authorised firms. Further details are available in its response to Dame Elizabeth Gloster's Report of the Independent Investigation into the FCA's Regulation of London Capital & Finance plc.

4: PAC conclusion: The way that compensation has been provided in the British Steel Pension Scheme case has been slow and unfair.

4a: PAC recommendation: In considering the implementation of a consumer redress scheme for BSPS members the FCA should consider how further redress mechanisms can be implemented more quickly and provide fair compensation.

4.1 The FCA has considered how further redress mechanisms can be implemented more quickly and provide fair compensation.

4.2 The FCA Business Plan for 2022/23 sets out its plans to improve the redress framework, including carrying out redress exercises with firms where appropriate, so they can quickly remedy harm. There are several ways for firms or the FCA to deliver redress to consumers, including a complaints-led approach, voluntary firm-led approaches, or a more formal redress scheme imposed by the FCA on a statutory basis (such as section 404 multi-firm redress schemes and single firm redress schemes). Some of the more formal approaches may take more time to implement than others, but redress should be consistent and fair regardless of which approach is chosen.

4.3 There are a number of factors that can affect how quickly consumers can access redress including consumer engagement and firms' willingness to co-operate. The FCA understands that many consumers who transferred out of BSPS are not considering making a complaint about the advice they were given. Some of these consumers have vulnerable characteristics and need help to identify whether the advice they were given was unsuitable. The FCA took this into account when considering whether a section 404 scheme was desirable compared to alternative options to ensure consumers receive redress.

4.4 The power in section 404 of the FSMA is a rule-making power (see paragraph 2.5). Before consulting on a consumer redress scheme, the FCA must carefully consider whether the relevant legal tests set out in FSMA are met. Prior to consulting on a scheme, the FCA will actively seek to engage in discussions with the industry and consumer groups about the issue. This process will assist in the consideration of all the available options and, if it is ultimately decided to pursue a scheme in order to address the issue, will ensure the FCA has a clear understanding of the issues that will need to be addressed in the formal consultation.

4.5 Rules made by the FCA under this power will be subject to a formal public consultation, including a cost benefit analysis. The FCA must also allow a reasonable amount of time for consultees (including financial services businesses) to submit their views, and for the FCA to give these responses due consideration. Where the FCA's proposals are more complex and/or have a greater impact on firms, as will often be true in the case of a section 404 scheme, the evidence base the FCA needs to collate will necessarily be more comprehensive, and the consultation time period may need to be longer. In the case of CP 22/6, the consultation was open for three months.

4b: PAC recommendation: It should also consider how to resolve differences in the levels of compensation received by BSPS members to date, and how this compares to the amount that other members will receive from the proposed FCA redress scheme.

4.6 The FCA will consider the feedback from the Committee as part of its wider response to the BSPS redress consultation and broader feedback statement on compensation as set out below.

4.7 The redress calculation methodology is designed to respond to changes in financial markets by taking account of the market's expectations of economic variables such as inflation and investment returns. When carried out correctly, redress calculations should produce an appropriate redress figure at the point at which the redress is calculated. This is because the calculated figure is based on a best estimate of the economic circumstances to which the consumer is likely to be exposed from that time. The methodology is designed to put consumers back in the position they should be in by estimating the amount they will need at retirement to purchase an annuity that would replicate the DB pension benefits they would have received. That amount is then discounted to determine the amount needed in today's terms. The redress amount is then the difference between the amount needed in today's terms and the current DC pension pot. Paragraph 4.8 explains how changes in the amount of compensation a consumer receives does not mean they are not receiving the right amount of redress.

4.8 The FCA considers it most likely that changes in economic circumstances between calculations explain why consumers in apparently similar positions (eg age, length of service etc) receive different levels of compensation. Paragraph 4.7 explains that the redress calculation is a 'point in time' calculation. Irrespective of when during a given quarter a redress calculation is carried out, firms are expected to calculate redress 'as at' the start of the quarter using assumptions that relate to economic circumstances at that date. Economic circumstances can change between quarters, but, as the methodology is designed to take account of these changes, these differences do not mean there are times at which it is more or less favourable to have redress calculated. The methodology works in a way that means calculations undertaken at different points in time always target an amount which aims to put a consumer back in the position they should have been in, by providing enough to purchase the same benefits via an annuity.

4.9 The Financial Services Compensation Scheme (FSCS) compensation limits were last reviewed between 2016 and 2018. In light of feedback received, the FCA increased the limit from £50,000 to £85,000 for certain categories of claim for firms declared in default by the FSCS from April 2019 onwards. This limit was considered to represent an appropriate balance between consumer protection and the cost to industry levy payers, which is ultimately passed to consumers.

4.10 In December 2021, the FCA published the Compensation Framework Review discussion paper. In this paper, the FCA explained that it thought that current compensation limits are set at an adequate level to cover a reasonable proportion of customers' claims but that it is interested in hearing views from stakeholders on whether changes should be made. The FCA is currently considering next steps, including whether it might be appropriate to reconsider whether the current limits continue to provide an appropriate level of consumer protection. The FCA will publish a Feedback Statement later in 2022.

4.11 In September 2022, the FCA published further information for consumers on how firms work out how much redress a consumer may be due if they received unsuitable DB pension transfer advice. This also provided further explanation on how the FCA's redress calculation methodology is impacted by changes in the economy, and the potential changes to calculations following the FCA's consultation.

5: PAC conclusion: Seven years after the Pensions Schemes Act, regulated bodies are still not clear on the Financial Conduct Authority's expectations for consumer protection.

5a: PAC recommendation: The FCA should be more proactive and consumer-focused in its engagement with stakeholders. It should have a better mechanism for responding to consumer harms and collect more evidence on a regular basis to pick up on issues that are being raised, especially from emerging risks in financial markets.

5.1 The FCA agrees with the Committee's recommendation.

First part of the recommendation: Implemented

5.2 The FCA's Business Plan sets out its commitments for tackling conduct that can cause serious harm and how the organisation is joining up its tools to act efficiently, effectively, and consistently. This is exemplified by how the regulator is responding to the digitisation of financial services.

5.3 On BSPS, working in partnership with the FOS and the FSCS, the FCA has engaged extensively with former BSPS members over a significant period of time. The FCA sent direct mailings in 2018, 2019 and 2020, ran local events in 2019 and 2021, and communicated through trusted intermediaries (including steelworkers, MPs and unions), to raise awareness of their right to complain/claim. It has also provided tools, such as the FCA's advice checker, to make it easier to do so. This engagement has been constructive. For example, 272 former BSPS members attended face-to-face events in South Wales and Scunthorpe in late 2021. 86% of attendees surveyed said they were now clearer about their next steps and following the events there was an uplift in FOS complaints. In the summer of 2022, the FCA has discussed its redress consultation directly with over 50 former BSPS members and over 200 firms.

5.4 The FCA regularly engages with industry to understand developments across the financial services industry and any emerging risks. It values its relationships with trade bodies, firms, consultants, consumer organisations and other stakeholders, who provide market insights and help us identify potential problems. We also monitor a wide range of data sources that provide insights on firms and consumer behavior, helping in our identification of emerging risks and themes. Subsequently these risks are triaged, prioritised, and fed in to forward looking work plans. The significant investment the FCA is making to become a data-led regulator set out above will assist its detection of and response to emerging risk across all financial markets.

5.5 On consumer engagement, the FCA uses a range of methods to engage with consumers and understand their experience of financial services, their needs and the potential for harm within the wider economic context. For example, the FCA's consumer partnerships network draws in insight which informs its policy development and builds relationships and understanding with consumer groups. The FCA's consumer market research, including the Financial Lives Survey (a nationally representative survey of UK consumers) also helps the FCA to identify harms and improve consumer outcomes. Financial Lives provides data on the characteristics of vulnerability including poor health, a life events, low resilience or low capability.

5.6 Further information on how this recommendation has been implemented is contained within letter from the Chief Executive of the FCA to the Chair of the Committee, dated 28 September 2022.

5b: PAC recommendation: The FCA must also review how effective the Financial Services Consumer Panel is at consumer protection and how it influences policy debates within the FCA from a consumer angle.

5.7 The FCA considers this recommendation is best addressed through the Treasury's work on the Future Regulatory Framework and the work of the panels is considered in the legislation now before Parliament.

5.8 The FCA would like to refer the Committee to our letter of 18 May 2022, which explains the remit of the Consumer Panel. The Panel's role is advisory and focused on matters of policy or supervision at the general level. Statute does not provide grounds for the Panel to act on behalf of individuals with a complaint, either against the FCA or a firm it regulates, or those pressing for compensation or redress.

5.9 Following the announcement of Pension Freedoms, the Panel responded to HM Treasury's consultation, the Work and Pensions Committee and the FCA's consultation paper CP 15/30 on pension reforms. The Panel provided extensive input and challenge at each stage of the Retirement Outcomes Review, and subsequently identified a range of regulatory remedies to protect consumers from poor outcomes, improve consumer engagement and promote competition.

5.10 On DB pension transfer advice, the Panel provided responses to various FCA consultations and advocated for and supported a ban on the practice of contingent charging. The Panel has also had discussions more recently with the FCA about the proposed redress scheme and to understand and comment on more fully the nature of the issues with BSPS.

6. PAC conclusion: The current compensation arrangements do not always protect consumers, can create wider costs to firms and may not have the capacity to cope with future risks in the advice market.

6a: PAC recommendation: The FCA, FOS and FSCS should write to the committee in 6 months to explain what they are doing to manage risks in the redress system for financial service.

6.1 The FCA, FOS and FSCS will write to the committee on 21 January 2023 to explain what they are doing to manage risks in the redress system for financial service.

6b: PAC recommendation: The FCA's handling of the wider DB pension market should be reviewed as there could be thousands more cases of mis-selling which may be eligible for financial redress, given the significant amount of unsuitable advice seen across the sector. The review should include consideration of solutions in circumstances in which an industry-wide levy is insufficient to pay out compensation to those who are eligible.

6.2 The FCA disagrees with the Committee's recommendation and does not consider that a review of how it is handling the wider DB transfer market should be undertaken.

6.3 Based on the evidence the FCA holds and the extensive work it has undertaken in this market, the FCA considers the harm associated with BSPS is unique and not replicated elsewhere. Our evidence suggests 46% of BSPS transfer advice was unsuitable compared to 17% in higher-risk firms in non-BSPS pension transfer cases.

6.4 The FSCS is funded by the collection of two levies from the financial services industry, the compensation costs levy and a management expenses levy covering operational costs. Compensation costs can vary significantly from year to year, depending on the number of firms that fail and the extent of any liabilities that they leave behind.

6.5 The current funding model includes a number of mechanisms to ensure that there is sufficient funding to compensate claimants who are entitled to receive compensation. Each FSCS funding class has a levy limit or 'threshold'. This is the maximum amount of costs which can be allocated to that particular class in a financial year. If compensation costs in a funding class are so high that the threshold is breached, firms in other classes are called upon for contributions via the retail pool. In highly exceptional circumstances where all classes breach their thresholds and the retail pool is maxed out (if the annual compensation costs exceed £1,225,000,000), the FSCS can apply for funding from the National Loans Fund.