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Rt. Hon. Mel Stride MP
Chair
Treasury Committee
House of Commons
London
SW1A 0AA

26 November 2020

Our Ref: SA201104

Dear Mr. Stride,

The work of the Financial Conduct Authority

After the session with the Committee on 4 November 2020, I committed to provide further information on a range of topics. Thank you also for your letter of 13 November 2020 with some further questions. I have sought to answer both sets of questions in this response. Charles Randell is writing to you separately with respect to your questions on the Complaints Scheme consultation.

FSCS protection

In the session, you asked what actions the FCA is taking to address increasing Financial Services Compensation Scheme (FSCS) levies. I summarise below some of our steps to address these issues, including our work in the consumer investments market and investing in better use of data and analytics to detect harm and intervene earlier. I have also included an overview of how we are monitoring firms' financial resilience and working to achieve more orderly outcomes from failure.

The UK's consumer compensation scheme provides broader coverage than most, if not all, compensation schemes in other jurisdictions. This protection ensures consumers are protected from harm and have the confidence to do business with financial services firms, benefiting all firms in the industry.

FSCS costs are allocated across different funding classes, relating to the type of business that a claim for compensation involves. A firm's levy is based on the overall levy costs for the class, its eligible income and the eligible income of other firms in the class.

The FCA aims to prevent FSCS costs arising in the first place through supervision and enforcement. Our Business Plan for 2020/21 highlights consumer investments as a priority area over the next three years, with three targeted outcomes. First, ensuring that investment products are appropriate for consumer needs. Second, making sure consumers are able to make effective decisions about their investments. Third, ensuring firms and individuals operate under high regulatory standards and act in consumers' interests.

Improving consumer investments outcomes

On 15 September, we published a Call for Input[1] (CfI) on the Consumer Investments Market. This CfI looks at areas where the consumer investments market is not working well and seeks views on changes we can make to improve protections and outcomes in this market to benefit both consumers and firms.

This CfI will help us develop a system where firms which cause redress liabilities pay more of the bill before recourse to the FSCS. This would be fairer and would also incentivise firms to achieve good consumer outcomes. We have asked for views on possible approaches. These include requiring firms to hold more capital based on risk, changes to the type and amount of Professional Indemnity Insurance (PII) firms must have and charging FSCS levies based on risk. These approaches aim to ensure that firms who are likely to cause the problems pick up the costs of redress before they go into default and burden the FSCS and levy payers.

We will publish a feedback statement in the first half of next year to summarise the responses we receive and next steps, including on FSCS levies.

Using our data strategy to improve detection and intervention

As part of the FCA's Data Strategy[2], we are prioritising work to make better use of data and analytics to detect harm and intervene earlier.

We have delivered, or are in the process of delivering, several projects to improve our capabilities. These include developing our use of tools such as web-scraping to spot web adverts from pension scammers and other fraudulent operators, and network analytics to identify individuals and companies involved in phoenixing or connected to fraudulent activities. Phoenixing in this context involves firms and individuals deliberately seeking to avoid their liabilities to consumers or poor conduct history by closing down firms – or resigning senior positions – only to re-emerge in a different legal entity. We are also exploring the use of predictive, machine learning tools which use our data to spot risky firms sooner.

Supervising and improving defined benefit transfer advice

Using data and risk indicators has enabled us to intervene effectively in the Defined Benefit – Defined Contribution (DB-DC) pension transfer market, identifying advice firms with higher risk business models and carrying out extensive assessments. As a result, we assessed 85 firms, accounting for over 40% of the market. Following our work, 28 firms stopped providing DB transfer advice.

In addition to the 85 firms assessed, we gave detailed feedback to 1,649 firms on areas of practice they needed to review in their advice model. This included the volume of clients they recommended to transfer, use of unauthorised introducers and recommending expensive solutions. We also asked firms to put things right if they found advice that was not suitable.

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[1] https://www.fca.org.uk/publication/call-for-input/consumer-investments-market.pdf
[2] https://www.fca.org.uk/publications/corporate-documents/data-strategy

After writing to the 1,649 firms, 402 firms chose to vary their permissions and they will not be advising on DB transfers in future.

Where we identify serious misconduct, we refer firms and individuals for enforcement investigation. We are currently undertaking investigations into over 30 regulated firms and a higher number of associated advisers where the principal focus is DB benefit transfer advice.

In June, we also set out measures to improve standards, building on our previous work. This includes a Guidance Consultation to help those advising on DB transfers to provide good quality advice, an 'Advice Checker' for consumers, and policy changes to address conflicts of interest in charging for DB transfer advice.

In the longer-term, where our policy and supervisory work improves the quality of DB pension transfer advice and reduces the risk of poor consumer outcomes, all DB transfer advice firms still in the market, or returning to it, should benefit from lower PII costs. We also welcome recent proposals from the Department of Work and Pensions (DWP) introducing new provisions requiring trustees of occupational pension schemes to nudge members to appropriate guidance when they seek to access their pension through the pension freedoms.

Professional indemnity insurance (PII)

As well as firms' concerns about the high cost of FSCS levies, we recognise the concerns over PII premiums. However, firms with capital or PII cover that reflects their risk profile are more likely to avoid costs falling on to the rest of the industry through the FSCS if they fail.

Insurers offering PII to advisory firms providing defined benefit (DB) transfer advice have been reducing their cover and increasing premiums. As a result, we know that some advisory firms, including those providing suitable advice, face difficulties in getting adequate PII cover or facing higher premiums than in the past. We hope to understand more about the issues in the PII market through our Call for Input.

Reducing phoenixing

There are more than 5,000 firms and over 27,000 individuals providing advice. That is a challenging market to regulate and bad actors use various methods to try to hide. However, we continue to take decisive action, including tackling 'phoenixing' as individuals move from one firm to another to avoid their liabilities.

This work is an important part of our assessment of firms and individuals as they seek to enter or exit the regulated financial advice sector. A current focus is on scrutinising applications for authorisation for a pre-emptive type of phoenixing that we call 'life-boating'. This is where the directors of an existing firm set up and seek authorisation for a new firm in full knowledge that their existing operation will receive complaints in the future about their previous poor advice. If authorised, they aim to transfer their assets to the new firm, leaving their liabilities behind. This means the customer cannot claim full redress from the original firm and the FSCS has to pay compensation. As well as life-boating, our checks also aim to identify a more traditional form of phoenixing, where a firm cancels its authorisation only to re-emerge at some point later with an identical or very similar business model, or 'fronting', where individuals with a clean regulatory

history are put forward to front financial advice firms that are being run in the shadows by those who do not meet the FCA's standards of fitness and propriety.

At the Authorisations gateway, we have a particular focus on tackling phoenixing and preventing individuals avoiding the consequences of their unsuitable advice by moving to or setting up new firms. This work is helping to reduce the burdens on FSCS fees on an ongoing basis. We recognise that, if the firm does not pay these liabilities, they will, at least partly, fall to the FSCS at a cost to the industry as well as to consumers whose losses may not be fully covered.

In the past year, we have prevented twelve firms from gaining authorisation where we suspected phoenixing. In two other cases, we placed conditions on our approval of the firms to ensure they could not avoid liabilities.

Our phoenixing measures also cover financial advice firms seeking to cancel their authorisation. We check to establish whether these firms are motivated by a desire to avoid liabilities. We require cancelling firms to confirm their arrangements for dealing with liabilities, for example via run-off PII cover.

We are paying close attention to candidates that financial advice firms put forward for approval as holders of 'senior management' or 'controlled' functions. We aim to identify those with a history of giving unsuitable advice - or of having allowed others to give poor advice on their watch - particularly for DB pension transfers. This area has significant scope for potential liabilities. Our aim is to prevent these individuals, and those that have deliberately avoided their liabilities, from being able to continue to operate in financial services and make the same mistakes.

The current climate increases the potential for phoenixing in light of the higher risk of firms failing. For this reason, we have included the risk of phoenixing in our strategies for dealing with firm failure across all relevant sectors.

Data on redress awarded and compensation paid out by the Financial Ombudsman and FSCS respectively is also crucial to the success of our work to tackle the avoidance of liabilities through phoenixing. We interrogate this data on a frequent basis. We collaborate with the Ombudsman and FSCS, as well as the Insolvency Service, through the Financial Services Regulatory Family Phoenixing Working Group. This was set up in 2018 to share trend data, develop data analytics and run joint initiatives to tackle phoenixing.

Managing firm failure

The FCA regulates approximately 49,000 solo regulated firms prudentially, and leads on resolution should any of them fail. This includes financial advisors and insurance intermediaries, SIPP operators, non-bank lenders, payments and e-money firms, and investment firms (including prime brokers). It also includes certain market infrastructure including exchanges, asset managers and around 24,000 real economy firms with a licence to sell consumer credit. Where the FCA is the resolution authority, we consider those firms that are not systemic should be able to fail, as orderly entrants and exits are part of a well-functioning market. However, significant failures can harm consumers, the effectiveness of markets, and overall confidence in

the UK's financial system. Therefore, we seek to ensure that firms fail in an orderly way and harm to consumers and disruption to markets is kept at a minimum.

In 2019, around 340 solo regulated firms were reported to have entered insolvency proceedings. The overwhelming majority of these firm failures were managed with little harm identified, while a smaller proportion required significant regulatory intervention to manage the resulting harm. Taking the Bank of England's macroeconomic scenarios, failures are expected to disproportionately impact some types of business models, creating potentially significant harm to consumers, reducing effective competition, and/or damaging the overall effectiveness and reputation of the market in which the firms operate.

Monitoring firms' financial resilience

In response to the crisis, we are monitoring the effects of economic downturn on firms' solvency through four main sources: 1) existing regulatory reported data, 2) enhanced data purchased from a third-party provider, 3) in-depth analysis of liquidity for a large number of the most significant firms, and 4) data collection on the impact of Covid-19 on cashflow and income from 23,000 firms through our financial resilience surveys. To date, we have issued four surveys and we plan to publish aggregated data and commentary in the coming weeks.

This means we have rapidly increased our available data on the firms we regulate. We have used this to provide more granular monitoring across the majority of the 49,000 firms we prudentially regulate to give an early warning about firms' financial resilience.

Alongside assessments of financial resilience, we have also considered which types of firms could potentially cause the greatest economic harm in failure. We have prioritised consumer harm through loss of client assets or segregated funds, failure to pay redress claims/Ombudsman awards and lack of FSCS cover. We are also considering the potential loss of access to services for particularly vulnerable markets and are generally concerned about any threats to competition and the effective functioning of markets.

From our analysis, a market downturn driven by the current economic conjuncture in light of the pandemic risks significant numbers of firms failing. As at the end of October, we have identified potentially 4,000 firms as having low levels of financial resilience and being at a heightened risk of failure, though many will be able to find ways to bolster their resilience as economic conditions improve. These are predominantly small and medium sized firms. Approximately 30% have the potential to cause a higher degree of harm. Of these, 68% potentially have FSCS coverage, although that will depend on the type of business they conduct and the nature of the underlying customer. The economic situation is rapidly evolving and therefore these numbers are dynamic. Announcements such as the potential development of a Covid-19 vaccine and extension of Government support package bring about sharp movements in the market and reduce the risk of firm failure.

We have also identified some sectors where a combination of market dynamics, or the regulatory and legislative framework, present barriers to orderly wind down. We are actively speaking to Treasury officials on these issues.

Bounce Back Loans Scheme (BBLS) and delays in processing applications

Ms Thewliss asked for further details on numbers of applications under the BBLS that are currently outstanding and information on delays to businesses.

As I explained during the hearing, the lending process for BBLS was expressly written out of the Regulated Activities Order (and so is not an activity regulated by the FCA). The British Business Bank (BBB) administers the scheme with significant involvement from the Treasury. We have let the Treasury and BBB know you are interested in data on how many applications for loans are currently outstanding and any further information on delays. The element that has been retained within our regulatory perimeter is the collections process for regulated loans (primarily those made to unincorporated SMEs). This will be an important focus of our work in collaboration with the Treasury and BBB.

We have engaged with regulated firms that are providing loans under the scheme and have sought to understand the scheme-specific challenges they face. We have also engaged with other stakeholders on these issues, sharing information and intelligence as it arises. From this work, we know that firms cannot process many of these applications in just a few days due to the checks they have to carry out under the Money Laundering Regulations, as well as fraud checks. It is right and necessary that firms carry out these checks to help minimise the risks of these schemes being abused and we have set out our expectations[3] on this. As part of our oversight of firms and stakeholder engagement we routinely engage with the Financial Ombudsman Service to understand the causes of complaints about the scheme. We will continue to monitor the situation in coordination with other relevant authorities.

Premier FX

Further to my comments at the Committee, for reasons of fairness and to avoid prejudicing the outcome of our ongoing investigation into the failure of Premier FX, I cannot comment on it in any detail. I can confirm that it is fully resourced and is making good progress. On 29 October our Executive Director of Enforcement and Market Oversight, Mark Steward, met the Liquidators and the Liquidation Committee to update them on progress. The Liquidation Committee represents the interest of the creditors of Premier FX, including its customers.

I explained to the Committee that the main Director and controlling shareholder of Premier FX has died. Nevertheless, we are working hard to produce as full account as we can of what happened, and we are looking to publish our findings in respect of Premier FX soon, subject to due process. Whether we can recover funds for Premier FX's customers will depend on what we find in the course of the investigation. I will update you further when we are able to do so.

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[3] https://www.fca.org.uk/news/statements/uk-coronavirus-business-interruption-loan-scheme-cbils-and-new-bounce-back-loan-scheme-bbl

Impact of the pandemic on pension access decisions

The Committee asked whether we had projected the extent to which people may release money from their pension pots because of the pandemic, and I committed to providing data on early drawdowns of this type.

As part of our Covid-19 monitoring work, we have carried out scenario analysis. We are using internal and external sources of information to help us understand emerging trends in consumer behaviour and the potential risks to consumers when accessing their pension. Initial indications suggest that consumers had been accessing their pensions less than usual at this time of year. The latest HMRC flexible payments data[4] suggests that the number of individuals accessing their pension dipped 2.3% from Q1 to Q2 2020, when normally we would see it peak, before increasing by 2.1% from Q2 to Q3 2020. Withdrawals typically peak in Q2, at the beginning of the tax year, before dropping in Q3. This change in behaviour may be due to the pandemic, with people potentially delaying flexible income withdrawals from their pension, possibly to avoid realising losses from market volatility and missing out on any increases in value from a future market recovery.

While the number of individuals accessing their pension flexibly increased by 6% in 2020 Q3 compared to 2019 Q3, this is considerably lower than the year-on-year growth we have seen recently as more consumers access their defined contribution pension flexibly.

We monitor possible spikes as the economic and financial impacts from the latest coronavirus restrictions are felt by consumers. Furlough and the Covid Job Retention Scheme have deferred redundancies so we have yet to see the full impact. For example, we might expect pensions access to increase as government support schemes are wound back and withdrawn.

If and when consumers do seek to access their pension, it is important they understand the full consequences of their decision and that accessing a pension early may not be in their long-term interest.

Guidance to firms on pension access and advice

With this in mind, on 7 April 2020 we issued Covid-specific guidance[5] for firms about how they can have meaningful discussions with consumers about the risks and consequences of accessing their pension, without straying into providing advice. The guidance also outlines some relevant risk factors in the current circumstances and how providers might make their customers aware of the implications.

Alongside The Pensions Regulator (TPR) and the Money and Pensions Service (MaPS), we have urged consumers to get independent guidance (from Pension Wise) or advice before taking any major decisions about their pension.

We are working closely with Government and other regulators in a cross-organisation Pensions and Covid-19 Working Group to coordinate our response. Given the spectrum of possible policy

[4] https://www.gov.uk/government/publications/flexible-payments-from-pensions/flexible-payments-from-pensions#october-2020-official-statistics

[5] https://www.fca.org.uk/firms/pensions-and-retirement-income-our-guidance-firms

options to address potential harm, we seek evidence and indicators to inform our approach. Our upcoming 'vulnerability and harms' survey is a representative survey of over 22,000 UK adults, and includes pension questions to give us an early indication of consumer intentions for the coming months.

Implementation of the Financial Guidance and Claims Act's pension guidance provisions

The Committee asked about our progress on implementing the pensions guidance provisions contained in the Financial Guidance and Claims Act 2018.

The Act requires us to make rules for providers to ensure that, before a consumer can proceed with an application to access or transfer their pension savings:

- the nature and purpose of pensions guidance is explained to the consumer; and
- the consumer either receives appropriate pensions guidance or opts out of receiving guidance.

In July, MaPS published their evaluation report[6] from their behavioural trials with three defined contribution pension providers. The trials explored more effective ways of prompting people to take Pension Wise guidance before accessing their retirement savings. Since these results were published, we have been working closely with the DWP on the proposed rules and regulations for pension providers and trust based schemes. The DWP published their Statement of Policy intent[7] on 28 October 2020, outlining their high-level proposals. We intend to consult on our own proposals in the coming months, in parallel with the DWP's full consultation.

Beyond the 'final nudge' work that I mentioned at the hearing, there are a number of initiatives we have put in place to ensure consumers have access to the right support and information. These initiatives include 'wake up' packs, supporting consumers accessing their pensions and dashboards.

Wake-up packs

The nudge required by the Act is often referred to as the 'final nudge' because it applies when consumers access their pension. We have already put in place other requirements to increase the take-up of Pension Wise guidance at earlier points in the consumer journey. Our existing rules require firms to issue 'wake-up' packs to consumers as they approach retirement. These give consumers information about their options for accessing their pension savings and signpost them to Pension Wise guidance. As a result of our work on the Retirement Outcomes Review, we made changes to our 'wake-up' pack rules so that firms send these packs earlier and more frequently. Since November 2019, providers are required to send a 'wake-up' pack to consumers at age 50 and every five years thereafter until they have fully taken their pension pot.

Supporting consumers accessing their pension

[6] https://www.bi.team/wp-content/uploads/2020/07/The-Stronger-Nudge-FINAL-1.pdf
[7] https://www.gov.uk/government/publications/stronger-nudge-to-pensions-guidance-statement-of-policy-intent

When consumers do decide to access their pension, it is important that they are supported in making their choices. In the first three years of the pension freedoms, a third of pension pots accessed for the first time were accessed without advice, compared to 5% before the freedoms. Our Retirement Outcomes Review showed that, among non-advised consumers entering into drawdown:

- many focused only on taking their tax-free cash and took the investment 'path of least resistance';
- a significant number were likely to be holding their drawdown funds in investments that will not meet their needs; and
- 33% held their whole drawdown pot in cash accounts, or exclusively in 'cash like' funds (we calculated that these consumers could get an income from their pot up to 37% higher over 20 years by investing in a mix of assets rather than just cash).

From February next year, we have required firms to offer so-called 'investment pathways' to non-advised consumers to help them decide how to invest their money when they access their pension savings using drawdown. We expect the introduction of the investment pathways to significantly reduce the probability of consumers making unsuitable purchases which fail to meet their retirement objectives.

Dashboards

Looking to the future, we remain committed to making dashboards a reality. We will continue to work closely with Pensions Dashboards Programme, Government, TPR and industry stakeholders to ensure that, when launched, pension dashboards can deliver good outcomes for consumers.

Protecting consumers from bad Defined Benefit transfer advice

Since pension freedoms, significant numbers of DB scheme members have transferred to defined contribution (DC) schemes so they can access their money flexibly. DB scheme members have a statutory right to transfer, although legislation requires that in most cases they have to take advice before proceeding. Our aim is to protect consumers from poor outcomes when they take advice on transferring from a DB pension to a DC pension.

Since 2015, we have undertaken extensive work that shows that too many consumers have not received suitable advice. Around 17% of the advice we have reviewed was unsuitable. For 28% of the advice, it was unclear if the advice was suitable as there was insufficient information recorded. These consumers may have suffered financial loss. As I have highlighted previously, we are currently undertaking 30 enforcement investigations against firms and individuals, and our work has led to a fall in the number of firms with the permission to advise on DB transfers. Where we identify unsuitable advice, we expect firms to review the DB transfer advice they have provided and put things right.

We have also intervened to address the key drivers of poor advice. These include failings in firms' advice processes, levels of adviser competence and failing to adequately manage conflicts of interest. We have done this by making new rules and guidance that set out the advice framework that firms should follow, as well as by raising qualification standards and introducing compulsory continuing professional development on pension transfer advice. We have also

reduced the scope for conflicts of interest by banning advice charges that depend on whether a transfer proceeds.

We continue to monitor this market closely. Data for the period from October 2018 to March 2020 shows a significant decrease in the proportion of consumers seeking advice on transfers who then proceed to transfer. We have also seen a fall in the proportion of insistent client transfers. During the pandemic, we have published tailored information for firms on how we expect them to give advice. We also have regular engagement with the Financial Ombudsman Service and the FSCS, which helps us to target our action in areas with the greatest risk of harm to consumers.

Additional questions in your letter of 13 November

In your letter of 13 November, you asked a number of additional questions that the Committee did not have time to raise during the evidence session. I have set out below responses to the questions on Woodford, Authorised Corporate Directors and our work on loyalty penalties.

Woodford and Authorised Corporate Directors

You asked for an update on our investigation on Woodford and when the Committee can expect a resolution. In line with normal policy, we don't provide public commentary on progress of an investigation. However, we can say that our investigation is making good progress. No decision has been made and the investigation is ensuring all relevant evidence is gathered. It is not appropriate to speculate on whether the FCA will take action at this stage.

We referred to a review of 'host' Authorised Funds Managers (AFM), sometimes referred to as 'host' Authorised Corporate Directors, in our asset management portfolio letter of 20 January 2020. In a typical scenario, while the AFM is responsible for the overall management of a fund, it delegates investment management activities, such as buying and selling shares in line with the investment strategy, to another entity (the 'delegate investment manager').

Sometimes funds are managed by AFMs that are not within the group structure of the delegate investment manager. In these cases, a conflict of interest may arise if a 'host' AFM cannot oversee the fund properly because, for example, it is concerned to avoid a loss of revenue from the investment manager if it were to offer more assertive challenge. We are concerned that 'host' ACDs may not be undertaking their responsibilities effectively in some cases, leading to poor value products and them failing to ensure risks are properly managed. We are reviewing how effectively 'host' ACDs undertake their responsibilities. We are seeking evidence that these firms can discharge their responsibilities properly, including in the day-to-day management of the fund. This work was delayed due to the Covid-19 pandemic; we now expect to complete it in the first quarter of 2021.

FCA work on loyalty penalties

You asked for an update on our work to combat the 'loyalty penalty' in different markets and to outline what further work we have planned.

General insurance

In September this year, we published the final report of our General Insurance Pricing Practices Market Study[8], which found that home and motor insurance markets were not working well for all customers.

We found extensive evidence of some firms gradually increasing the price to customers who renew with them year on year. This is called price walking. Firms use complex and opaque pricing techniques to identify consumers who are more likely to renew with them. Firms then increase prices to these customers at renewal each year resulting in some loyal customers paying very high prices. In addition, some firms use practices that can discourage consumers from shopping around. While lower prices are available for consumers if they regularly switch or negotiate with their existing provider, price walking distorts competition and increases costs for both consumers and firms, leading to higher overall prices for consumers. In 2018, six million policyholders paid high prices. If they had paid the average for their risk they would have saved £1.2bn in that year.

In September, we also published a consultation paper[9], proposing a package of measures to address these concerns. These include a pricing remedy, which would require providers of home or motor insurance to offer a renewal price to a customer no greater than the equivalent new business price the customer would be offered through the same sales channel. We estimate that average prices will fall by £3.7bn over the next 10 years as a result of our proposed pricing remedy.

The pricing remedy will be accompanied by enhanced product governance rules to help ensure that firms deliver fair value for all consumers. These proposals would apply to all general insurance and pure protection products. We want to drive changes in firms' behaviour by requiring them to consider how they deliver long-term fair value in their insurance products.

We have also seen practices that make it difficult for consumers to cancel automatically renewing contracts. This can deter them from switching to better deals with other suppliers. We therefore propose to ensure that firms make it easy for customers to stop a contract from auto-renewing and make it easier for consumers to decline auto renewal for policies.

The consultation on these measures is due to close on 25 January 2021. We intend to publish a Policy Statement and final rules in Q2 2021, with the rules taking effect four months later.

Mortgages

Our Mortgage Market Study (MMS), the final report of which was published in 2019, found that the mortgage market generally works well for consumers, with high levels of switching and apparent competition on headline rates. However, it also found that a minority of borrowers with active lenders remained on a reversion rate such as a lender's standard variable rate for over six months but were able to switch and would benefit from switching.

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[8] https://www.fca.org.uk/publication/market-studies/ms18-1-3.pdf

[9] https://www.fca.org.uk/publication/consultation/cp20-19.pdf

We commissioned research[10] to understand more about borrowers who could switch but are not doing so. The results were published in March 2020. We had planned to develop proposals to help mortgage borrowers who do not switch in the second quarter of 2020, but timelines for this work were delayed, as we have needed to prioritise our response to the pandemic.

In addition, our Statement on mortgage prisoners[11], published in July, outlined the range of actions we have taken to support 'mortgage prisoners', who are borrowers up-to-date with payments but who cannot switch. These are a different cohort of borrowers to those covered by the loyalty penalty work, who are able to switch but aren't currently doing so.

Cash savings

In 2015, our Cash Savings Market Study (CSMS) found that the market was not working well for longstanding customers. It estimated that if all customers holding accounts of £5,000+ that received below the market average interest rate instead received the average rate, the benefit would be £500-900 million a year. This figure would be significantly lower in the current low-interest rate environment.

In January this year, we consulted on introducing the Single Easy Access Rate (SEAR). This would require firms to set a single rate for their easy access cash ISAs, and a single rate for their other easy access cash savings accounts, that they must pay after the account has been open for more than a year. This would prevent firms from paying lower rates to longstanding customers, and firms would set this single rate higher than current rates for longstanding customers, to reduce the loss of deposits after an account had been open for 12 months.

In the current economic environment, interest rates for new products have fallen, and so has the gap between rates paid to new and longstanding customers. This means the size of the harm originally estimated in the CSMS is now significantly lower. We therefore do not consider that introducing the SEAR would be proportionate to the current level of harm in this market and on 13 November announced we would stop further work on the SEAR proposal. However, we will continue to monitor the market and we may revisit our priorities if we see significant harm to consumers in the future.

Proposed remedies and compensation

You have also asked if the remedies the FCA propose for the loyalty penalty include compensation to affected customers. Our proposed general insurance remedies only apply going forward, and will not apply retrospectively.

Our proposed rules also require firms to review their existing products to ensure they provide fair value going forwards. Some firms may take remedial action, including potentially to pay redress, if they identify historic harm to consumers as a result of rules that were in place at the time.

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[10] https://www.fca.org.uk/news/news-stories/fca-issues-research-mortgage-switching
[11] https://www.fca.org.uk/publication/consultation/statement-on-mortgage-prisoners.pdf

Consumers can complain to their general insurance provider about any issues or problems they have experienced and, if they are not happy with the response, they can take their complaint to the Financial Ombudsman Service.

I trust the information provided in this letter will be helpful to the Committee.

Yours sincerely,

Nikhil Rathi

Nikhil Rathi
Chief Executive