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Rt Hon Frank Field MP
Work and Pensions Select Committee
House of Commons
London
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Dear Mr Field,

8 June 2018

Self-Invested Personal Pensions

Thank you for your letter of 22 May 2018 regarding Defined Benefit (DB) pension transfers and non-standard investments (NSIs) in self-invested personal pensions (SIPPs). You ask a number of questions which I will respond to in turn, but before I do I thought it might be useful to provide some background to our work in this area.

As you are aware, we have been looking at SIPPs for some time, and our retail investment team continues to focus on areas where advice is less suitable, including high-risk investments and pension transfers. Since 2009 we have been particularly concerned with the quality of some of the NSIs being held in SIPPs and the due diligence conducted before accepting them.

NSIs are often high risk and illiquid investments and are generally only suitable for sophisticated investors who are willing to accept the level of risk involved. It is important to note that not all NSIs are problematic as the term also includes, for example, UK commercial property and some cash deposits.

However, our concerns with some NSIs are exacerbated by the potential for scams. Our work on pension scams has found evidence that other types of consumers have invested in these assets, usually as a consequence of being targeted by unregulated introducers. An issue I know is one of interest to you. I now turn to your questions.

1. ***What is the value and proportion of funds transferred from DB pension schemes into SIPPs in the last two years which are held in the form of non-standard or unregulated investments?***

The FCA collects a large amount of data related to pensions and pension transfers. In 2015 and 2017 we collected data from all firms operating a SIPP. This told us that the total amount of all NSIs held in SIPPs (from all sources) was circa £5.97bn as of September 2017. This accounts for approximately 2% of the total £300.21bn of assets under management with the largest contract-based SIPP operators (as at March 2017).

During 2017 the total amount withdrawn from DB funds was £22.44bn. The total amount of NSIs held in SIPPs from all sources is significantly lower than that taken out of DB schemes. In relation to SIPPs, we do not have general data on the proportion of funds transferred from a DB pension scheme into an NSI, but we do have information on the destination of funds in NSIs held in SIPPs. In relation to DB schemes, we look for this information as part of our supervisory file reviews of specific cases and thematic work.

As I have mentioned above, we are concerned about investments in NSIs using SIPPs regardless of whether the source was a DB scheme or otherwise. We remain concerned that pension savers are a potential target for scams, and so our supervisory work in this area has taken into account the underlying investment in assessing if that advice appears suitable or not. We issued alerts in 2013 and 2014 detailing our concerns and reminding firms that they

must consider the investment as part of their advice. We are working with the Pensions Regulator (TPR) on a joint communications campaign to raise awareness of pension scams. This will be run under our ScamSmart campaign brand and will launch in the summer.

2. *What due diligence are SIPP providers required to conduct on the investment that they provide access to, and how does the FCA monitor this?*

We require firms to comply with our Principles for Business and therefore conduct their business with due skill, care and diligence. We also require them to treat their customers fairly. We do not prescribe an exhaustive list of the factors they should consider as part of their due diligence checks as we believe firms need to ensure they are taking effective, appropriate action in each individual case.

We do have rules in place which oblige SIPP operators to assess if there are problems with an investment and/or an introducer. By carrying out this due diligence they would be required to take appropriate action, which may include declining to proceed with the investment.

Our supervisions teams continue to monitor how firms meet our expectations and we use our day to day supervisory work to target our resources where intelligence tells us that there is a risk of harm to consumers. This work includes targeting specific firms to review their due diligence procedures, particularly where we suspect that they might be accepting higher risk investments. Our findings so far have been that most firms have adapted their due diligence to meet our expectations, or have voluntarily exited the market as a result of our scrutiny.

It might be useful to highlight our recent intervention in a civil court case - which is awaiting judgment - where we summarised what we expect SIPP operators to do in terms of due diligence:

i. SIPP operators should take reasonable steps to ensure that it does not accept into the SIPP an asset that is likely to give rise to tax liabilities within the scheme;

ii. a SIPP operator has a responsibility to take reasonable steps to ensure that a proposed underlying investment for a SIPP is a genuine asset, and is not part of a fraud or scam;

iii. a key part of the task of a SIPP operator is to receive, hold and administer the underlying assets held in the SIPP. In order to carry out that role in accordance with the client's best interests in accordance with COBS 2.1.1R, a SIPP operator must satisfy itself that it or its trustee has proper custody of and good title to the underlying asset. Other FCA Handbook rules, in particular the Client Assets Sourcebook (CASS) and Principle 10 (a firm must arrange adequate protection for clients' assets when it is responsible for them) may also be relevant to the holding of client assets. The precise content of the duties depends on the type of asset in question.

iv. SIPP trustees are subject to specific obligations to provide clients with realistic annual valuations of the assets held in a SIPP. For a SIPP operator to accept an underlying asset into a SIPP without having taken reasonable steps to ensure that it or its trustee will be able to undertake realistic annual valuations would amount to a failure to act in the client's best interests, in breach of COBS 2.1.1R.

3. *What powers does the FCA have to punish SIPP providers for failure in due diligence, and how have these powers been used?*

The FCA has a vast array of formal and informal powers and I will highlight the most relevant ones based on your questions. Where we decide intervention is necessary, we will always take

the most appropriate course of action and use the powers that will be the most effective in each individual case.

Our formal powers include commissioning Skilled Persons Reviews (also called section 166 reports) where we believe an independent view would add to our understanding of an issue. The reports generated by the Skilled Persons are then assessed by the relevant area of the FCA to decide whether, and what, further action is needed. We currently have one live Skilled Persons Review underway that relates to the due diligence performed when accepting a NSI. I cannot go into more detail on this case at this stage as this is ongoing.

Separately to a Skilled Persons Review, we can also impose a requirement on a firm to take, or cease, a particular action – this is called an Own Initiative Requirement or OIREQ. Where a firm agrees with the FCA for a formal requirement to be placed on it, we would use a voluntary requirement (VREQ). A VREQ follows discussions between the FCA and the firm, and is usually offered by the firm based on those discussions.

A VREQ is an important tool which enables us to take early, and swift, action to address our concerns over potential consumer harm. We have previously used VREQs to secure redress for consumers in other regulated sectors, such as some consumer credit areas. A number of SIPP operators have offered, and had accepted, VREQs to cease accepting higher risk NSIs while they review their due diligence processes and brought them in line with our expectations.

Where we find serious failings by SIPP operators we give consideration to referring the firms, principals or both to our Enforcement and Market Oversight Division (EMO). So far two SIPP operators have been referred to EMO in relation to NSI due diligence failings.

EMO investigates further and decides whether additional, more punitive measures are required. Here we would consider using our extensive range of disciplinary, criminal and civil powers which can be used against regulated and unregulated firms and individuals who are failing, or have failed, to meet our standards. These powers could result in banning individuals, imposing fines, initiating criminal proceedings or seizing assets – among other action.

An additional point I would make here is that where people are persuaded to place their pension into a SIPP there is usually a financial adviser involved, often an unregulated introducer, who has given advice to do this. We have 33 open investigations into advisers who we suspect have given poor advice and we are considering what action to take in each case. In addition we have already prohibited four financial advisers and banned another from holding senior positions as a result.

4. ***In what circumstances can a SIPP provider be deemed liable to pay compensation to a customer whose funds ended up in an unsuitable investment scheme, rather than the financial adviser who arranged the investment?***

A breach of our rules by a SIPP operator resulting in a loss to a consumer could give rise to a claim for negligence and/or breach of statutory duty under section 138D of FSMA. This could arise, for example, where the SIPP operator has breached our rules on undertaking sufficient due diligence, which has meant that the consumer has invested in, and lost money because of, an NSI. Note that a breach of the Principles is excluded from section 138D. A consumer may alternatively bring a civil case for a SIPP operator's breach of its common law duty of care. Several court cases, involving SIPP operators and relating to investors who did not take regulated financial advice, are currently progressing through the courts and we are intervening in these cases. Aside from legal action, consumers can use the complaints process and the Financial Ombudsman Service.

To raise a complaint against the SIPP operator or adviser (should there be one), the consumer would need to first complain to the firm. We have clear rules in place for firms on how they must handle complaints, and this includes the right for the consumer to refer a complaint to the Financial Ombudsman Service for consideration where they disagree with the conclusion by the firm.

The FCA is not able to intervene in individual disputes as this is the role given by Parliament to the Financial Ombudsman Service. The Ombudsman Service is free to consumers and can issue legally binding decisions that can be enforced by the courts. If a firm does not abide by the Ombudsman's decision, or if it does not cooperate with the Ombudsman Service, they would be referred to the FCA for us to consider taking further action for non-compliance with our dispute resolution rules.

Earlier in your letter you highlight some of your concerns relating to the Financial Services Compensation Scheme (FSCS) cover available where firms cease trading – possibly to avoid liabilities. You may be aware that we recently consulted on, among other things, raising the statutory limit for FSCS claims from £50,000 to £85,000. We think this is an appropriate balance between consumer protection and a cost to the industry. The increase will apply to claims for all defaults on or after 1 April 2019. The consultation paper can be found on our website here: https://www.fca.org.uk/publication/consultation/cp18-11.pdf.

As you may know, in January the FSCS declared 3 SIPP operators in default on the basis that they were unable, or likely to be unable, to satisfy protected claims against them. The 3 firms were Stadia Trustees Limited, Brooklands Trustees Limited and Montpelier Pension Administration Services Limited.

FSCS has received a number of claims for compensation in relation to these SIPP operators. In addition to being the SIPP operator, Stadia and Brooklands were also the trustees of the SIPPs. In relation to Montpelier, the FCA cancelled its permission on 14 October 2011 and the managing director was the subject of enforcement action by the FCA. This concluded that he was not a 'fit and proper person' on the basis of failings including in respect of due diligence on introducers and SIPP assets. The FSCS is now considering whether it will assess claims against the firm.

5. ***Is the FCA considering the option of barring unregulated or non-standard investments altogether from inclusion in SIPP's?***

Until 2016 HM Revenue and Customs (HMRC) maintained a permitted investment list which highlighted what investments could be placed in a pension. They have now moved to a model which does not dictate what can be placed in a pension, rather which types of investments attract tax relief. The effect of this is that many more types of investments can now be placed into pension schemes such as SIPPs.

We are not currently considering barring unregulated or NSIs from inclusion in SIPPs. We believe suitable advice from financial advisers accompanied with effective due diligence checks by SIPP operators is a more proportionate way of preventing harm to consumers rather than imposing a ban.

As I have mention above it is important to note that not all unregulated or NSIs are high risk. Some investments are deemed non-standard because they are not capable of being liquidated within 30 days. Commercial property and fixed term deposit accounts are key examples of this. We would not necessarily want to ban sophisticated and high net-worth individuals from making these investments should they wish to, based on sound advice and consideration.

Our concern has been where mainstream investors invest in certain types of products. On 4 June 2013 we published final rules to ban the promotion of Unregulated Collective Investment

Schemes (UCIS) and certain close substitutes (together to be known as Non-Mainstream Pooled Investments (NMPIs)) to the majority of retail investors in the UK. The rules mean that, in the retail market, promotions of these riskier and often complex fund structures will generally be restricted to sophisticated investors and high net-worth individuals for whom these products are more likely to be suitable.

I hope that my response has addressed your questions. However, I would be happy to discuss this important issue with you further if that would be of use.

Yours sincerely,

Megan Butler
Executive Director of Supervision – Investments, Wholesale and Specialists Division