Rt Hon Frank Field MP
Chair, Work and Pensions Committee
House of Commons
London
SW1A 0AA

Dear Frank,

18 January 2019

Our Ref: SA181128A

**RE: British Steel Pension Scheme: Financial Services Compensation Scheme**

Thank you for your letter of 28 November 2018 regarding the compensation payments from the Financial Services Compensation Scheme (FSCS) to former members of the British Steel Pension Scheme (BSPS) who were advised by Active Wealth (UK) Ltd. Please accept my apologies for the delay in coming back to you on this; this is a complex issue and we wanted to ensure a full response.

Before I turn to your specific questions, I think it would be useful to provide some background on this issue as well as our role and remit with the FSCS.

**FSCS**

The FSCS is operationally independent, in a similar capacity to the Financial Ombudsman Service. The FSCS was created by the Financial Services and Markets Act 2000 to protect financial services consumers should a regulated firm fail and be unable to meet claims against it. It was set up by Parliament as a compensation fund of last resort, free for consumers to use. It is funded by levies paid by authorised financial services firms.

The FCA’s role and remit with respect to FSCS compensation awards for unsuitable defined benefit pension transfers is simple. The FCA sets the guidance for redress for firms; the FSCS uses this as a starting point when calculating suitable compensation. We are also responsible for setting the cap for compensation claims to the FSCS. However, as you will see from my responses to your questions below, the FSCS does have discretion that it can apply to many aspects of its redress calculations.

**Background**

Much of the background to this issue is known to you and the Committee already, but it is probably useful to set out some of the relevant details to provide context for both your questions and my answers. I will not restate the details that tie directly into the circumstances around BSPS, as these are covered in previous evidence we have provided to the Committee as well as my letter of 18 January 2018 and our meeting on 6 November.

The FSCS is currently considering claims from former members of the BSPS who were advised by Active Wealth (UK) Ltd. The firm filed for liquidation in February 2018 and soon after the FSCS began accepting claims.
Within a few months the FSCS had issued determinations on a number of claims – however, questions were soon asked over the rationale for the calculations it had made. This prompted a meeting on 22 November 2018 with former BSPS members, hosted by their MPs – Nick Smith, Stephen Kinnock and Tonia Antoniazzi. Megan Butler, the FCA’s Executive Director of Supervision, attended alongside the Pensions Regulator (TPR), FSCS and the Pensions Advisory Service (TPAS).

During the meeting, the former BSPS members set out their concerns, via their solicitor. Their concerns centered on three issues:

1) The date used for their transfer valuation. Members felt the one used meant their compensation was not an accurate reflection of their losses. The FSCS undertook to reconsider cases where it used a valuation that was more than a month old.

2) Additional charges should be taken into account and the product charge should not be assumed as 0.75%. Members said they incurred charges that may differ from fixed assumptions made by the FSCS.

3) The discount rate applied by the FSCS. Members wanted the FSCS to depart from its position of applying the rate set out in the FCA’s guidance. They provided two arguments for this: the first based on the ‘treatment’ of BSPS members by Active Wealth; and the second related to the level of risk members would be willing to accept.

Following Active Wealth entering liquidation, we have been in regular contact with the FSCS, particularly in light of the concerns raised by former BSPS members over the compensation payments.

**The FCA’s position**

As I have mentioned, the FSCS is operationally independent and is therefore open to take the action it sees as appropriate in the circumstances. It does not need the FCA’s approval regarding the particular methodology to apply in compensation calculations, but in order to provide some insight to aid its considerations, we wrote to the FSCS’ Chief Executive Mark Neale, on 12 December 2018.

The FCA’s position, as set out to Mark Neale, is that the circumstances surrounding BSPS are unique and sensitive. These left members with a considerably difficult decision to make, with impending deadlines and a very heavy air of mistrust over the situation with their employer and pension scheme itself. This, accompanied with the actions of a few financial advisers, placed BSPS members in a difficult position through no fault of their own.

The actions of a few financial advisers further encouraged a quick and significant surge in transfer requests. As we have set out to you before, both in oral evidence to the Committee, and during our very constructive meeting of 6 November 2018, we are aware of who these advisers were and our work on these events continues. Despite the interventions of the FCA, TPR and TPAS, a number of BSPS members transferred out of the scheme, despite what may have been in their best interests, sustaining losses for which the FCA feels they should rightly be compensated.

Taken together, the FCA feels the FSCS should determine this to be an exceptional case, which would give it appropriate grounds to apply its discretion on whether to follow the FCA guidance. However, we appreciate this is a decision solely for the FSCS to make in the circumstances it deems appropriate.
Your questions

How is the limit of £50,000 decided? When was it last considered?

The cap on FSCS compensation for investment business has been set at £50,000 since 2010. We have recently completed a review of the FSCS funding model and as part of the review we considered whether the limits provide an appropriate level of protection to consumers. In May 2018, we confirmed final rules raising the £50,000 compensation limit to £85,000 for defaults on or after 1 April 2019.¹ This followed consultation with stakeholders which confirmed our view that this limit represents an appropriate balance of consumer protection and cost to industry.

Data from the FSCS show that the number of claims that are paid out up to the cap limit of £50,000 have increased over the past few years. Increasing the limit to £85,000 will give those who have suffered losses a higher chance of getting full compensation. It also sets the limit at the same level as that currently set by the Prudential Regulation Authority (PRA) for deposits, making the compensation levels more consistent across different types of services, and decreasing the risk of consumer confusion about the protection the FSCS can offer.

Are there any circumstances in which the FSCS can exceed this limit? If not, why not?

The compensation limit cannot be exceeded. This is because the FSCS is a compensation scheme of last resort funded by levies on live firms that are authorised by the FCA and the PRA. There is a difficult balance to be struck when ensuring an appropriate degree of consumer protection being available by the FSCS when it is active firms paying for a failed firm’s liabilities. The FSCS exists to mitigate risk to the consumer where a firm fails, but it was not created by Parliament to provide an absolute level of protection for these same reasons.

The limits are kept under review and, as explained above, we have recently decided to increase the £50,000 compensation limit (which currently applies to investment business, home finance intermediation and debt management claims) to £85,000 with effect from 1 April 2019.

Do you think 0.75% is a realistic assumption of pension charges and how was this figure decided?

The FCA’s redress methodology was informed by a report we commissioned from PricewaterhouseCoopers LLP (PwC) in 2017. We appointed PwC to review the previous methodology and provide recommendations for a new methodology.

Following its review, PwC recommended a rate of 0.75% saying it expected consumers would be able to invest in low investment risk funds with charges of 0.75% or less. Consumers who invest in funds with higher fees would also typically expect a higher rate of return and PwC did not consider it suitable for the redress methodology to compensate consumers for taking this additional risk.

Before finalising the assumption, the FCA consulted on the recommendations and carefully considered the responses we received. The FCA’s position in the finalised guidance (FG17/9²) was that – as the majority of consumers are already in, or are able to access, products with charges of 0.75% or less – actual charges may be used, up to a maximum of 0.75%, to provide fair redress.

¹ For investment provision, investment intermediation, home finance and debt management claims
Any actual charges previously taken from the pension pot are automatically taken into account, as are future ongoing product and advice charges. These include those associated with purchasing an annuity. However, the level of these can be varied if the FSCS thought this was appropriate in the circumstances.

Why is it not possible for the FSCS to deduct from the pre-retirement rate the actual costs incurred by the individual in continuing charges, rather than a blanket maximum of 0.75%?

I mentioned above that we wrote to Mark Neale in December to provide some insight on a number of points that may be useful to the FSCS when considering claims for compensation for former BSPS members. Two points, which may be relevant to this question, were also covered in our letter. The first, the application of FG17/9. The second, additional points the FSCS may wish to consider.

On the first of these, we have had discussions with the FSCS on the extent to which FG17/9 is relevant to the consideration of BSPS related cases. Our Handbook\(^3\) sets out that the FSCS may pay compensation based on what the claimant would have recovered at law\(^4\) 'to the extent that the FSCS considers the payment of compensation is essential in order to provide the claimant with fair compensation'.

Under general principles of administrative law, when calculating compensation in a particular case, the FSCS should consider our guidance as a relevant factor, along with all other relevant factors including its internal policies.

In some cases, those factors include the rules relating to claims covered by the Pensions Review for protected investment business. However, our view is that these rules do not directly apply to the BSPS because they are confined to pension transfers within the scope of the Pensions Review and the Free Standing Additional Voluntary Contributions Review. BSPS cases do not fall within scope of either review.

The FSCS has an internal policy of using, as a starting point, the Pensions Review methodology as applied and modified by FG17/9. We recognise that this policy was developed to create fairness between pension transfer claimants within, and outside, the scope of the Pensions Review. However, the FSCS has discretion in the way it calculates compensation – and the extent to which it applies FG17/9 – where there are particular circumstances that would mean it considers that to be appropriate.

Our understanding, following our conversations with FSCS' legal team, is that under common law precedent any amount should be based on what claimants would have recovered at law and be subject to downward discretion.

Based on this, we feel the relevant guidance in FG17/9 and our Handbook may not apply here, and that there is sufficient scope for the FSCS to consider varying from these.

Turning to the second point, in our letter to Mark Neale we highlighted that our view is any actual charges previously taken from the pension pot are automatically taken into account, as are ongoing product and advice charges – including any charges associated with purchasing an annuity. We also highlighted that the level of these could be varied, particularly where any maximums have been suggested that might not be applicable in the circumstances.

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\(^3\) [https://www.handbook.fca.org.uk/handbook/](https://www.handbook.fca.org.uk/handbook/)

\(^4\) COMP 12.4.2R
Taking these two points together, our view is that the FSCS may be able to, in the circumstances, exercise discretion over the manner in which it calculates compensation for former BSPS members. Again, it is important to stress that the FSCS is operationally independent from the FCA and so it would need to consider all these points, and any others it may feel are relevant, in order to form its decision.

**Please could you confirm the FCA’s guidance on scheme valuations for the purposes of calculating compensation. In particular, I would be grateful if you could clarify whether you think it is appropriate to calculate compensation on the basis of a valuation conducted on a single day without regard for past performance or future projections?**

The FCA’s guidance, as set out in FG17/9, is intended to provide fair redress. As I have set out above, The FSCS has discretion over how it applies this in particular cases. The guidance works by suggesting a calculation methodology which aims to provide consumers with sufficient funds now to purchase, on retirement, an annuity equivalent to the lifetime income provided by the former scheme (this is known as equivalent benefits).

At the date of the calculation, the valuation of the equivalent benefits is compared against the value of the transferred pension pot at that time. The pot value will take account of all past performance and charges which have already been deducted. Where the equivalent benefits valuation exceeds the value of the pension pot, the difference will represent the amount of redress payable.

If the calculation took place on a different day:

- the transferred pot value would be different and represent the performance and charges reflected to that time, but
- the equivalent benefits valuation assumptions would also have changed to reflect new estimates of future returns.

Whenever the calculation takes place, the aim is to calculate an amount which will cover any losses that have been incurred. We recognise that no matter when the calculation is carried out, there is a risk that the redress may prove insufficient given the nature of the assumptions you are needing to make.

**Next steps**

I want to reaffirm a point I made earlier; this is a unique and sensitive case. The difficult decision BSPS members had to make has meant a number of them have sustained losses for which they should rightly be compensated. It is also true that some former members may never be able to recoup their full losses; however our view is that adopting a different approach from FG17/9 in this exceptional case could allow some of these members to be put back – in as far as is possible in the current circumstances – into the position they should have been in, within the compensation limits set out in our rules.

While this is an issue for the FSCS to consider, the FCA will continue its discussions with it to ensure we are providing any assistance we are able to.
As you may be aware, the Treasury Committee also has an interest in this issue, as such, I am copying my response with its Chair, the Rt Hon Nicky Morgan MP. I am also copying this letter to Mark Neale, the Chief Executive of the FSCS.

I hope that this is helpful.

Yours Sincerely,

Andrew Bailey
Chief Executive

cc. Rt Hon Nicky Morgan MP, Chair of the Treasury Select Committee
cc. Mark Neale, Chief Executive of the FSCS