National Audit Office

Investigation into the British Steel Pension Scheme

Financial Conduct Authority, Financial Ombudsman Service, Financial Services Compensation Scheme

REPORT

by the Comptroller and Auditor General

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Report by the Comptroller and Auditor General

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Gareth Davies
Comptroller and Auditor General
National Audit Office

14 March 2022

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Investigations

We conduct investigations to establish the underlying facts in circumstances where concerns have been raised with us, or in response to intelligence that we have gathered through our wider work.

Almost 8,000 steelworkers chose to transfer out of the British Steel Pension Scheme (BSPS), a large Defined Benefit pension, after receiving advice from their financial advisers. Subsequently, there have been concerns that this advice was unsuitable, and these pension members lost significant sums of money as a result. Financial advisers are regulated by the Financial Conduct Authority, while the Financial Ombudsman Service and the Financial Services Compensation Scheme award redress to consumers that have been treated unfairly. This investigation examines the regulation of Defined Benefit pension transfer advice in the BSPS case and the extent to which compensation is being delivered to steelworkers who have been affected.

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What this investigation is about

1 A workplace pension provides a retirement income for its members from a pot of money accumulated during employment. The two main types are Defined Benefit (DB) and Defined Contribution (DC) schemes. DB schemes provide a guaranteed income to its members in retirement, based on how many years they have worked and the salary they have earned. In contrast, DC schemes do not guarantee members a certain level of retirement income – this will depend on the contribution and investment choices made by each member.

2 The British Steel Pension Scheme (BSPS) was a large DB scheme sponsored by Tata Steel UK. In 2015-16, it had approximately 130,000 members (including 14,000 current employees, mostly located in Wales, the Midlands, Yorkshire and the Humber region, and North-East England) and £13.3 billion of assets. After Tata Steel experienced financial difficulty, in 2017, the BSPS was restructured. Around this time, 7,834 members (representing £2.8 billion of the fund) chose to transfer their benefits out of the scheme to a DC pension arrangement; 95% of these decisions were informed by independent financial advisers. Subsequently, there have been concerns that these members received unsuitable advice and may have made poor financial choices and lost significant sums of money as a result.

3 A wide range of bodies, including government organisations and regulators, have been involved in the BSPS restructure, the regulation of the pensions and advice markets, and the provision of redress to affected steelworkers. All the main organisations and bodies together with their responsibilities that have played key roles in the BSPS case are set out in Figure 3, on pages 17 and 18.

4 Two previous reviews have examined the BSPS case. In February 2018, the Work and Pensions Select Committee reported on the choices faced by members during the BSPS restructure in 2017. In January 2019, an independent review examined the communications and support provided to BSPS members at the time of the restructure.

5 This investigation focuses on setting out how DB pension transfer advisers were regulated in the BSPS case and the extent to which compensation is being delivered to members who were affected. The Financial Conduct Authority (FCA) regulates over 50,000 financial services firms and is responsible for supervising financial advisers, including the regulated advice provided to BSPS members. The Financial Ombudsman Service (the Financial Ombudsman) resolves complaints between financial services providers and their consumers. The Financial Services Compensation Scheme (FSCS) pays compensation to consumers in cases where a financial services firm is unable to pay claims made against it, because they are no longer in business. The report sets out:

- what the BSPS was and what happened to it;
- how the FCA was organised to prevent, identify and respond to unsuitable financial advice in the BSPS case, and how this was undertaken in practice;
- what the FCA, FSCS and the Financial Ombudsman have done to resolve detriment experienced by BSPS members who were mis-sold pensions advice, and to what extent compensation has been delivered; and
- what the impact of the BSPS case has been on pension members, the regulatory framework and the Defined Benefit pension transfer advice market generally.

6 This investigation is based on a review of documents provided by the FCA, FSCS and the Financial Ombudsman, as well as public information and interviews with a range of stakeholders. It sets out the facts of the case. It does not seek to examine and report on value for money, nor does it seek to examine the merits of individual regulatory decisions, for which there are specific procedures and bodies such as ombudsmen and tribunals. This investigation also does not cover the restructure of the BSPS and the adequacy of the pension settlement.

Summary

Key findings

Transferring out of the British Steel Pension Scheme (BSPS)

7 **In August 2017, when Tata Steel was facing financial difficulty, The Pensions Regulator (TPR) approved a request to separate the company from the BSPS.** Pensions law allows, under certain circumstances, a financially troubled employer to detach itself from its pension liabilities. This typically results in a Defined Benefit (DB) scheme entering the Pension Protection Fund (PPF). This fund is designed to protect members of a scheme where the sponsoring employer has become insolvent, but typically pays somewhat reduced pension benefits. TPR and the PPF agreed with Tata Steel that it could follow this approach for the BSPS. Additionally, Tata Steel set up a new successor scheme (which was offering to provide similar benefits to the BSPS but with lower future increases), with members being given the choice to move into this prior to the BSPS entering a PPF assessment period, in an exercise called 'Time to Choose' (paragraphs 1.5 to 1.8).

8 **Some members of DB pension schemes also have the option to transfer their funds out of the pension scheme altogether.** The Pensions Schemes Act 2015 gave people greater flexibility for accessing and using pension savings. For members of Defined Benefit (DB) schemes to take advantage of these flexibilities, they must transfer their benefits to a Defined Contribution (DC) scheme. Due to the risks involved, the Act also requires members with a pension value greater than £30,000 to take financial advice from a regulated adviser before transferring out. For the BSPS scheme, some 44,000 deferred members (those who had not yet accessed their pension and who were no longer earning increased benefits) had the option to transfer out of the scheme completely (paragraphs 1.3, 1.4 and 1.9).

9 **In 2015, the Financial Conduct Authority (FCA) recognised the increased risk of harm to consumers who receive unsuitable advice and transfer out of a DB pension.** Because a DB pension provides a guaranteed level of income in retirement, the FCA's guidance states that an adviser should assume that, in most cases, a transfer will not be suitable. In 2015, when the legislation was introduced, the FCA recognised that the reforms could cause harm to consumers who receive unsuitable transfer advice and began to analyse the advice market. In 2015-16, it found that 17% of the transfer advice it reviewed was unsuitable (compared with 4% unsuitability in other advice sectors). In 36% of cases, it was unclear if the recommendation was suitable or not. Out of the 13 advice firms reviewed, four voluntarily left the market (paragraphs 1.11 to 1.13).

Regulation of advice provided to BSPS members

10 BSPS members were particularly vulnerable to pension advice mis-selling. Pensions are a highly complex financial services product, and most BSPS members had limited previous experience of making decisions about their pension or using a financial adviser. The deadlines for the 'Time to Choose' exercise (December 2017) and for providing the necessary documentation to proceed with a transfer (February 2018) gave members limited time to make their decisions, while the value of members' benefits were substantial (the average transfer value was £365,000, with some worth more than £1 million). The two previous reviews found that the communication and support provided to members during the 'Time to Choose' exercise was not adequate to inform their decision. Stakeholders told us that there was an overall level of distrust in the viability of the sponsoring employer, given its financial difficulties and the pension restructure. Members were, therefore, more sceptical of leaving their savings with the company scheme (paragraph 2.2).

11 Around 18% of eligible BSPS members transferred out of the scheme. From April 2017, 7,834 members transferred out of the original scheme, representing £2.8 billion of the pension fund. Around 95% of the BSPS members who transferred out had received financial advice from a regulated firm (paragraphs 2.3 and 2.5).

12 The financial advice market was not prepared for the impact of the BSPS restructure. Advisers in the local steel-working areas saw very rapid growth in requests for DB transfer advice, which is a complex, specialised, and regulated area of financial advice. The FCA authorises firms to provide DB pension transfer advice. It told us that many of the advice firms involved had limited previous experience of processing large numbers of DB transfers and, in many cases, did not respond appropriately to the increased demand for their services. Most advisers were financially incentivised to recommend members to transfer out of the BSPS, as they were only paid if this happened. The FCA estimates that 79% of all BSPS members who received advice transferred out of the scheme (paragraphs 1.11, 2.5, 2.6 and 2.16).

13 In summer 2017, the FCA had limited insight into the DB transfer advice market and what was happening in the BSPS at the time of its restructure. The FCA did not have any data on the number of DB transfer requests that were taking place or on the state of the adviser market in the local areas. Data on the number of BSPS transfer requests were held by the scheme trustees and administrators, who are not FCA authorised, and the FCA was therefore not aware of the level of interest BSPS members had in transferring out of the scheme. Furthermore, only five out of the estimated 369 advice firms involved in the BSPS case met the FCA's size threshold for regular engagement with the regulator. Instead, the FCA's approach for these smaller advisers was limited to undertaking thematic work on key issues across the entire market and specific case work identified through intelligence (paragraphs 2.7 and 2.8).

14 **The FCA responded by working with industry and pension members to try to contain the most immediate harm.** Between November 2017 and March 2018, the FCA diverted staff from different teams to work on the BSPS, including 10 staff from its supervision department. It also deployed some staff to the local areas. It communicated with firms to remind them of its regulatory expectations. It arranged seminars with 151 advisers and, in January 2018, wrote to all pension transfer advisers in the UK to remind them of their responsibilities. It also communicated to BSPS members who were considering transferring out. In December 2017, the FCA worked with its regulatory partners to enable the scheme's trustees to issue a joint letter to around 12,000 BSPS members who had requested a transfer quotation, to urge them to be careful if considering this option. By January 2018, 2,054 transfers had been completed. The FCA followed up with a further joint letter, sent by trustees, to members who had already transferred out of the scheme and helped to organise a dedicated helpline for members seeking further guidance (paragraphs 2.9 to 2.11).

15 **The FCA estimates that financial advice was unsuitable in 47% of all BSPS cases and unclear in a further 32% of transfers.** After its initial response, in June 2018, the FCA undertook a longer-term project to understand the scale of unsuitable advice provided across the DB pension transfer market, including in the British Steel Pensions Scheme. It found that BSPS files showed a much higher rate of unsuitable transfer recommendations (47%) than for the DB transfer market more generally (17%). In a further 32% of BSPS transfers, it was unclear if the advice was unsuitable or not. Additionally, some advisers placed members into new pension investments that were not appropriate for their requirements. The FCA's evidence indicates this was the case in 17% of all BSPS transfers (paragraphs 2.12 and 2.13).

16 **The FCA has issued fines totalling £1.3 million and has 30 more enforcement investigations ongoing.** The regulator has a wide range of powers to respond to poor behaviour in a market, such as withdrawing or suspending a firm's authorisation or using its regulatory, civil, or criminal prosecution powers. In March 2018, the FCA opened enforcement investigations into eight firms that had provided advice to BSPS members and it currently has ongoing investigations into 30 individuals or firms. It told us that all but one of these firms have since stopped providing DB transfer advice. To date, it has imposed fines totalling £1.3 million for adviser non-compliance and has banned one individual from undertaking certain regulated activities, subject to a determination by an independent tribunal. Its interventions have also led to at least 44 firms voluntarily withdrawing from the DB pension transfer advice market (paragraphs 2.17 and 2.18).

17 The FCA recognised that it needed to change its approach to regulating the pensions transfer advice market. It has made changes to its internal processes in response to the BSPS case. For example, from 2018 it began collecting more data from financial advisers to improve its market intelligence. It has changed its approach to engaging with regulatory partners, such as developing a joint protocol to enable early intervention in DB transfer cases. The FCA also updated the qualifications it requires of advisers wishing to be approved as pension transfer specialists. To improve industry practices, in October 2020, it banned charges for advice where consumers only pay when a transfer proceeds, except in certain limited circumstances (paragraph 2.20).

Redress and putting things right

18 The FCA has worked with firms to provide redress directly to some BSPS members and encouraged other members to seek compensation by raising complaints. The standard process of redress is a complaints-based approach in which consumers first raise a complaint with their financial advice firm and, if unsatisfied with the outcome, raise a complaint with the Financial Ombudsman Service (the Financial Ombudsman). The FCA has focused on encouraging consumers to seek redress individually and ensuring individual firms review the suitability of their advice directly:

- **Individual complaints:** The FCA and wider regulatory system have worked to raise members' awareness of their right to complain, for example, through direct letters and in-person events. To date, only 25% (1,878) of members who received advice to transfer out have sought redress through individual complaints.
- **Suitability assessments:** In May 2020, the FCA decided that 45 firms that it considered may have given unsuitable advice should conduct suitability assessments (called Past Business Reviews). The FCA told us that, to date, two firms have completed their reviews and more than £12 million in compensation has been paid to affected BSPS members (paragraphs 3.2 to 3.8).

19 **The FCA is yet to decide on the implementation of a consumer redress scheme for BSPS members.** Regulators need to make timely decisions that can have an effective impact on the individual firms they regulate and the wider market, including, for example, deciding how to provide redress and compensation to affected steelworkers. The FCA has powers to mandate a consumer redress scheme for BSPS members, in which all firms involved in the BSPS case would have to review their advice and potentially offer compensation to consumers. However, before doing so it must meet certain legal tests by providing evidence of widespread or regular market failure and analysing the potential impact on the advice market. The regulator started assessing the suitability of a consumer redress scheme in April 2021 and it expects to launch a consultation on this by the end of March 2022. It also told us it needs to meet a similarly high evidence threshold before making other types of intervention, such as making changes to regulations and conducting enforcement actions (paragraphs 3.9, 3.10, 2.18, and 2.20).

20 **Pension scheme members have lost £18 million of redress to date as financial advisers went into liquidation.** The FCA requires firms to have enough resources to cover liabilities for unsuitable advice, which is usually achieved through Professional Indemnity Insurance. However, 22% of complaints made to the Financial Ombudsman have so far been passed to the Financial Services Compensation Scheme (FSCS) due to firms being unable to pay compensation and entering liquidation. The compensation awarded by the FSCS is limited to £50,000 for claims against firms that failed before April 2019 and £85,000 for firms that failed after that date. The average loss for BSPS claims resolved by FSCS is £82,600, with individual cases ranging from £0 up to £489,000. The FSCS has estimated that the total loss for its upheld BSPS claims is £55.3 million, and the total compensation awarded by FSCS is £37.3 million, resulting in a shortfall of £18 million (paragraphs 2.15, 3.11, 3.12 and 3.17).

21 **There have been wider market impacts from the costs of compensation.** After the BSPS case, the price of the relevant insurance cover for financial advisers increased significantly, with some insurers refusing to cover this type of risk altogether. BSPS claims to the FSCS also place financial pressure on the wider industry, as compensation is funded by a levy placed on advice firms and other businesses which offer similar services. The total cost of funding the levy, including operating costs, is expected to increase by 23% from £330 million in 2021-22 to £406 million in 2022-23. £90 million of the 2021-22 cost will be borne by the wider financial services industry. The FCA acknowledges the risks posed to the wider market and is considering ways to improve the compensation framework (paragraph 3.13).

22 The average BSPS complaint regarding unsuitable advice takes the Financial Ombudsman eight months to resolve. During 2020-21, the Financial Ombudsman has dealt with a 60% increase in non-PPI (Payment Protection Insurance) complaints. This created an initial unallocated backlog of 90,000 cases in April 2021, which has since fallen to 43,000 as at the end of January 2022. Representatives from the Financial Ombudsman also told us that DB pension transfer complaints are complex and time-consuming to resolve (paragraphs 3.18 and 3.19).

23 The total compensation awarded to scheme members is not recorded. Redress calculations use complex financial assumptions that change every three months according to the performance of financial markets. This leads to variations in the amounts of compensation provided to consumers, as each calculation is made at a different time. The FCA provides guidance on the calculation of redress and has acknowledged that, in some cases, aspects of its guidance were not being used consistently by advice firms, who risked failing to provide fair compensation amounts to consumers. The FCA has issued clarification to firms with the aim to mitigate this risk (paragraphs 3.14 to 3.17).

24 Seventy-two per cent of the Financial Ombudsman's cases and 40% of FSCS's claims have been made through claims management companies or legal representatives. Pension scheme members can seek redress free through the Financial Ombudsman or FSCS, but members may also choose to be represented by claims management companies or legal representatives, who charge a fee for their service. Therefore, some BSPS members have not received the full amount of redress owed to them, as part of their compensation has been paid to third parties (paragraphs 3.20 and 3.21).

Concluding remarks and matters for consideration

25 A large number of BSPS members have suffered a significant degree of financial detriment after transferring out of the scheme. Whilst the total loss experienced by members is not recorded, for claims made to the FSCS the average individual loss is £82,600. Pension scheme members were placed in a vulnerable position and the communication and support provided at the time of the BSPS restructure was not adequate. Furthermore, the regulated advice market, which was intended to be a key protection against financial loss, failed to protect them adequately, with 47% of advice deemed to be unsuitable.

26 The FCA has put in place measures aimed at improving the regulation of the pensions advice market, such as a ban on charges where advisers are paid only if a transfer proceeds, and along with the Financial Ombudsman and FSCS is attempting to remedy the financial detriment suffered by BSPS members. However, the redress arrangements have not compensated all individuals fully, the costs of redress have impacted on the wider financial services industry and the number of firms providing DB pensions transfer advice has more than halved. This case demonstrates the costs and difficulties of remedying failures in financial services, the importance of preventing problems occurring in the first place and the inadequacy of the arrangements for protecting BSPS members during the DB pension transfer process. We have therefore set out matters for consideration aimed at strengthening preventative measures:

a The introduction of pension freedoms in the Pensions Schemes Act 2015 relied on a number of measures to protect consumers, such as the provision of financial advice. The FCA and HM Treasury should consider whether there are lessons to be learned about the way they work together to identify and mitigate any risks to consumers as policy is being developed.

b While the exact circumstances of the BSPS may not be replicated, the risk of large numbers of pension members looking to transfer out of a DB pension remains. The regulators and oversight bodies with responsibilities for protecting pension scheme members should consider what further changes can be made to minimise the risks associated with transferring out of a scheme. This should include consideration of key regulatory factors, such as the strength of existing safeguards to protect consumers in the DB pension transfer process; the regulatory data needed to support proactive intervention and the powers to collect this; and the mechanisms and approaches that can be used to communicate key messages effectively with less accessible firms and consumers.

c The FCA, the Financial Ombudsman and FSCS have undertaken a range of activities to raise BSPS members' awareness of their right to complain and seek redress. Despite high levels of unsuitable advice, to date, only a small proportion of these members have made a complaint through the statutory redress organisations. The FCA, the Financial Ombudsman and FSCS should reflect on their experiences in trying to reach affected consumers to understand what worked well and what could be improved in future. This analysis should also feed into how they operate the new joint working framework, aimed at addressing similar issues that could have a wider impact across the financial services industry.