Hogan Lovells

Pension transfers and scams: what should trustees do?

September 2018

Pension briefing

HIGHLIGHTS

Pension scammers are becoming ever more sophisticated in their methods of parting scheme members from their pension funds, learning how to stay (just) on the right side of the law and to avoid breaching requirements of financial services legislation. Following recent determinations by the Pensions Ombudsman, it is clear that trustees are expected not only to:

- determine whether the member actually has a right to transfer to the proposed receiving arrangement (which may be complicated enough); but also to
- investigate receiving schemes in considerable detail and ensure that members are appropriately warned of the dangers of pension scams.

Even where the member has a right to a transfer value, the trustees may be held liable (for considerable sums) if they have committed maladministration in failing properly to investigate the receiving scheme and give appropriate warnings to members.

This note considers the current state of play in relation to pension scams and sets out practical steps which trustees can take to protect both themselves and their members.

REMINDER: WHAT ARE PENSION SCAMS?

Pension scheme members may be encouraged to "liberate" their pension savings by transferring to an arrangement that allows them access to the funds before their minimum pension age (usually 55).

Increasingly, however, scams involve persuading a member to transfer to another pension scheme offering enticing investment opportunities – sadly, these are usually too good to be true and members often end up losing most or all of their pension funds.

In most cases, the receiving scheme used for scamming purposes is an occupational pension scheme registered under the Finance Act 2004. Personal pension arrangements may only be established by entities authorised by the Financial Conduct Authority (FCA), and so are less attractive vehicles for scammers.

Reports from within the pension industry suggest that "international self-invested personal pensions (SIPPs)" are also being used by fraudsters.

Adverse consequences for the member

Payment of the proceeds of a pension that has been "liberated" before age 55 will almost certainly constitute an unauthorised payment under the Finance Act 2004. This will attract a 40% tax charge (and potentially an additional 15% surcharge, depending on how much of the member's pension is paid out). If the member does not declare these unauthorised payments to HMRC, there may also be penalties and interest to pay.

Where a member has been persuaded to transfer to schemes investing in high risk investments, there may be no adverse tax consequences but, instead, the member may end up losing much of his or her fund to poor investment performance, including insolvency of the investee companies. In these scenarios, members may often find that their contacts at the new scheme simply disappear, leaving them without a means of tracking their investments.

In any form of pension scam, there are often high fees in the form of a "commission" or "arrangement fee". This is rarely made clear to members at the outset.

Adverse consequences for trustees

Where a scheme pays an unauthorised payment, the scheme administrator will be liable for a scheme sanction charge of 40% of the amount of the unauthorised payment (reduced to 15% if the member has paid the unauthorised payments charge).

The Pensions Ombudsman may find trustees to have committed maladministration, and can require significant recompense – even where there is no unauthorised payment and trustees have complied with the letter of the law. For an example of where making a lawful transfer proved very costly to a scheme, please see the box below about the case of Mr N.

WHAT SHOULD TRUSTEES DO?

Pension scams have sadly been around for some time. With time has come increasing knowledge of scamming techniques and means of trying to avoid them. It is clear that trustees are expected to have an awareness of common types of scam and of good practice within the industry.

Before deciding whether to proceed with a transfer out, trustees should both:

- determine whether the member has a right to transfer; and
- assess the risks of the receiving scheme being used for scamming purposes.

Details of actions trustees should take are set out below

Industry guidance

Pensions Regulator (tPR)

tPR has moved on from its original "Scorpion" campaign launched in February 2013. It has issued a short flyer "Thinking of doing something with your pension pot?" which can be issued to members, plus a short transfer checklist for trustees.

Code of Practice

In June this year, the Pension Scams Industry Group (PSIG) reissued its Code of Good Practice on combatting pension scams, based on three core principles that trustees and administrators should:

- raise awareness of scams among members and beneficiaries;
- have robust and proportionate processes for assessing the risk of scams on transfers out; and
- be aware of current, known scamming strategies to inform the checks they make before making a transfer.

The Code contains a wealth of detailed suggestions for trustees on handling transfer requests. We've highlighted those we think most helpful in this note.

Mr N: member's benefits to be reinstated

In a determination issued this July, the Pensions Ombudsman directed Northumbria Police Authority to reinstate a former member's benefits in the Police Pension Scheme (at an estimated cost of £124,000), or to provide him with equivalent benefits from another provider. The member had requested a transfer out to a defined contribution occupational pension scheme which turned out to invest in high risk investments and which is currently, we understand, the subject of a criminal investigation.

The Ombudsman found that, when processing Mr N's transfer out request, the Authority had failed to conduct adequate checks and enquiries in relation to the proposed receiving scheme. In particular, it had not sent Mr N the Pensions Regulator's scorpion warning leaflet, nor had it engaged with him directly regarding the concerns it should have had. This was found to amount to maladministration, with a very costly outcome for the Authority.

When considering the implications of this case, it is important to remember that Mr N had a statutory right to transfer and that the Authority had acted entirely within the law in making the transfer.

DOES THE MEMBER HAVE A RIGHT TO TRANSFER (IN GENERAL)?

Broadly, a member has a statutory right to transfer his or her benefits out of your scheme if s/he meets the following conditions:

- the member has accrued rights to benefit under the scheme;
- none of the member's benefits to be transferred have crystallised (come into payment); and
- the member has stopped accruing benefits (for defined benefits, accrual must have ceased at least one year before the scheme's normal pension age).

Members may also have a right to transfer out under your scheme rules. In some schemes this may be an absolute right, while in others members may transfer out only with the consent of the trustees or sponsoring employer.

Does the member have a right to transfer to the particular scheme?

Alongside determining whether the member has a right to transfer out (whether under statute or the scheme rules), trustees should analyse whether the member has a right to transfer **to** the particular receiving scheme. The flowchart at the back of this note sets out the steps this should involve. There are some points which are worth drawing out.

- Scammers have picked up on legal requirements for establishing an occupational scheme and often know what to include in scheme documentation so as to pass the relevant legal tests.
- To acquire rights ("transfer credits") under the new scheme the member needs to be an earner (and have earnings from some source) but - under current law - does not need to be employed by a sponsoring employer of the receiving scheme. There are proposals to amend legislation to require a "genuine employment link" between the transferring member and the receiving scheme – please see the box on further statutory protection below.
- The Pensions Ombudsman has recently held that, where there were concerns about a proposed receiving scheme, the transferring scheme should have asked for a copy of the new scheme's trust deed and rules to check whether its trustees were able to accept a transfer in. If this was not allowed under the new scheme's rules, the member would not have had a statutory right to transfer to the scheme.

ASSESSING THE RECEIVING SCHEME

Information for members

The Pensions Regulator has produced a two page booklet for members on pension scams. Pension transfer packs sent to members should include this booklet. Where transfer information is not sent direct to the member (for example, because a financial adviser is contacting the scheme on behalf of the member), the warning booklet should still be sent to the member's home address.

Initial analysis

Transferring schemes should collect, as a minimum, the following information about the proposed receiving scheme:

- scheme name and address;
- HMRC registration number;
- details of how the transfer payment is to be made;
- the type of scheme (occupational scheme, small self-administered scheme (SSAS), etc); and
- the identity of the scheme administrator.

Where this initial analysis shows that the receiving scheme is a public sector scheme, an occupational scheme with a well-known sponsoring employer, or a scheme run by an established provider, the trustees can proceed with the transfer (provided the other conditions for a transfer are met).

You may find it useful to establish a "white list" of schemes and administrators which you have assessed in respect of previous transfer requests and which you already consider to be genuine. Further transfers to a scheme on your white list can be considered low risk.

Trustees should be aware, however, that some scam schemes can "impersonate" well-known schemes or schemes run by established providers. Care should be taken to establish that the scheme really is what it appears to be.

Due diligence on receiving scheme

The PSIG guidance sets out detailed questions which may be appropriate to ask about a proposed receiving scheme which is not already known. These include the following.

- Is an unregulated introducer involved in the transfer?
- Does the member's financial adviser (if any) have the appropriate permissions for the proposed transfer?
- If the receiving scheme is a self-invested personal pension (SIPP), is the operator regulated by the FCA? (Overseas providers which are not regulated in the UK cannot provide a SIPP – the EEA passporting regime does not apply).
- Do internet searches, FCA cases, etc suggest that the scheme administrator, trustee or another person connected to the scheme may have been linked to pension scams?
- Was the receiving scheme established only recently?
- Is the sponsoring employer of the new scheme actively trading?
- Are any of the proposed investments in the receiving scheme high risk or unregulated?

The guidance recommends that, if no concerns arise from these questions, the trustees may proceed with the transfer (provided the other conditions for a transfer are met).

Questions for the member

Some of the questions may be answered most easily by asking the member. The PSIG Code strongly recommends telephoning the member directly where possible – and makes clear that doing so does not constitute cold calling or giving financial advice. Where concerns remain, you could suggest to the member that s/he calls the Pensions Advisory Service (TPAS), who will be willing to talk through the transfer and will offer an impartial view.

Where there are concerns about the transfer, the member should be asked further questions, including:

- has the member taken regulated financial advice and, if so, was the advisor authorised to advise on pension transfers?
- was the first contact with the member a cold call?
- is the member expecting to receive a cash payment or loan in relation to the transfer?
- what does the member understands about how the transfer payment will be invested, and have any specific rates of return been promised?
- how do fees in the new scheme compare to the fees (if any) charged by the transferring scheme?

It may be appropriate to ask further questions specific to the type of pension arrangement, especially if it is located overseas.

You should be particularly concerned if your questions indicate that the member may be especially vulnerable, for example if s/he has low levels of literacy, numeracy or English language skills; is suffering from long-term illness or disability; or if the transfer is being made after a change in circumstances such as bereavement or job loss. The FCA has suggestions (www.fca.org.uk/publication/occasional-papers/occasional-paper-31.pdf) which should be considered where "customer vulnerability" is a concern.

If the member's responses do not raise concerns, you should proceed with the transfer (provided the other conditions for transfer are met).

Further due diligence

The PSIG Code sets out further information which may be sought about different types of receiving scheme. In relation to occupational pension schemes, this includes:

- information about any employment link (including evidence of earnings) between the member and the scheme's sponsoring employer – remembering that scammers can use false employment contracts as a means of hoodwinking transferring scheme trustees;
- information about the sponsoring employer, such as whether it is actively trading , the nature of its business; and whether it existed before the member asked to transfer;
- evidence of the geographical location of the sponsoring employer and the scheme, and how close these are to where the member lives;
- how the scheme (or intermediaries) have communicated with the member during the transfer process;
- copies of the scheme's governing documentation and accounts, paying particular attention to whether its address is a PO Box or a physical location and whether the same address has been used in relation to a number of schemes.

Transfers: statutory time limit

Where a member applies to transfer out and has a statutory right to transfer, the transfer must be made within six months of the application (for money purchase benefits) or within six months of the guarantee date shown in the relevant statement of entitlement (for defined benefits).

The Pensions Regulator has power to extend the six month time limit in various circumstances, including where the trustees cannot properly carry out the member's wishes because:

- the member has not taken all steps reasonably expected by the trustees; or
- the trustees have not been given such information as they reasonably require.

Where your initial enquiries raise concerns, consider applying for an extension to the statutory deadline. The application should be made within the six month time limit and should include the reasons for the delay in implementing the request and an estimate of the additional time needed.

Members with defined benefit rights valued at over £30,000 also need to take independent financial advice before they can transfer, and the trustees are not permitted to pay the transfer unless confirmation that such advice has been provided is received.

PROTECTION FOR TRUSTEES

Review of procedures

In reality, the detailed actions involved in dealing with members' transfer requests are usually carried out by scheme administrators rather than by the trustees. Trustees, however, retain the ultimate responsibility for scheme administration.

Trustees of most well-run schemes will already have transfer procedures agreed with their administrators. In light of growing understanding of scams and expectations on trustees, we recommend that you review these procedures with your administrators to ensure that they remain appropriate and up to date. Your procedures should include taking legal advice and having contact with law enforcement agencies, where appropriate.

Record keeping

You should ensure that you (or your administrator) keep detailed records of the questions asked, information obtained and decisions taken at each stage in the process of dealing with a transfer request.

Evidence collected about a particular scheme should be carefully recorded and retained. It may be useful in relation to subsequent transfer requests to the same scheme, as well as helping you to respond to any future claim.

Statutory discharge for trustees: what's it worth?

Where a member has exercised a statutory right to a transfer value, section 99 of the Pension Schemes Act 1993 discharges the transferring trustees from any further obligation to provide benefits related to the transfer out where the trustees "have done what is needed to carry out what the member requires".

In the case of Mr N (please see the box), the Pensions Ombudsman took the view that what was "needed" for these purposes included carrying out an appropriate review of the transfer request, taking into account not only the law but also regulatory guidance. He concluded that the transferring authority had not done this and that the statutory discharge therefore did not apply. We do not share this interpretation of section 99. However, even if the statutory discharge is in play, it would arguably apply only in relation to benefits from the transferring scheme and would not cover trustees' liabilities for compensation for maladministration.

Non-statutory discharge

To reinforce warnings to members, and to protect themselves, trustees should ask members to sign a suitable discharge when requesting that a transfer go ahead. The discharge form should refer to any advice or guidance the member has taken (or has chosen not to take) and to specific risks, including that accessing pension funds before age 55 will usually result in a 55% unauthorised payments charge. The PSIG code includes a sample discharge.

You should be aware, however, that a non-statutory discharge may not be effective in relation to claims by a member's dependants to survivors' benefits after his/her death.

Reporting concerns

If you do not pay a statutory transfer value within the six month time limit you should inform the Pensions Regulator. While the Regulator cannot predetermine any future regulatory action it may take, it will take account of evidence that a member's funds may be at risk when deciding whether to take action for the non-payment of the transfer.

Where appropriate, the Financial Conduct Authority (FCA) should be notified and a report made to Action Fraud (www.actionfraud.police.uk/report_fraud).

Future statutory protection

Cold calling ban

The government consulted earlier this summer on regulations which will prohibit cold calling in relation to pensions unless the caller is regulated by the Financial Conduct Authority (FCA) or the Pensions Regulator and one of the following applies:

- the recipient has previously consented to, or requested, calls being made on that telephone line; or
- the recipient has an existing client relationship with the caller, and the relationship is such that the recipient anticipates receiving unsolicited calls in relation to marketing pensions, provided that the recipient is given a simple means of opting out of calls free of charge.

The regulations are intended to have effect from autumn 2018.

Restricting rights to statutory transfers

Individuals' rights to a statutory transfer will be limited to apply only where the receiving scheme is:

- a personal pension scheme operated by an FCA-regulated body;
- an occupational pension scheme which is an authorised master trust; or
- an occupational pension scheme to which a "genuine employment link" can be demonstrated with the transferring member.

What is required to evidence a "genuine employment link" is not yet certain, but it is expected to include evidence of regular earnings from employment with an employer participating in the receiving scheme.

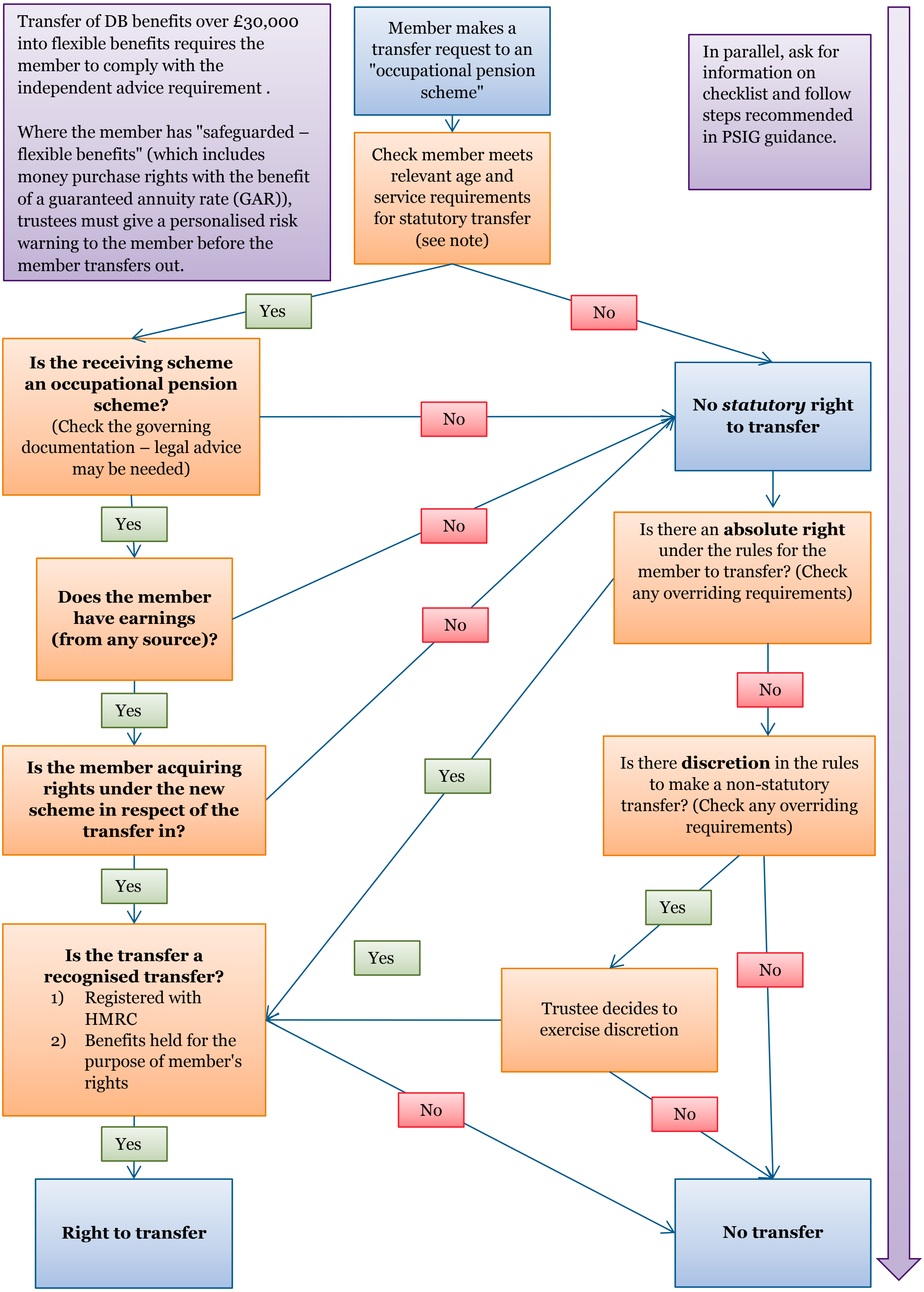
The restriction on members' transfer rights is not expected to apply until after the regime for the authorisation of master trusts is up and running.

Referring members to guidance

Obligations under the Financial Guidance and Claims Act 2018 will require trustees to refer members to appropriate pension guidance, and to provide the member with an explanation of the nature and purpose of the guidance, before the member transfers their rights out of the scheme or starts to draw benefits. Trustees must not give effect to the member's request to transfer or draw benefits until they have ensured that the member has either received appropriate guidance or has opted out.

The relevant parts of the 2018 Act have not yet been brought into force.

DOES THE MEMBER HAVE A RIGHT TO TRANSFER TO AN OCCUPATIONAL PENSION SCHEME?



This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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