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Kirsty Knight
Department for Work and Pensions
Policy Group
Private Pensions and ALB Partnerships
Zone A,
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Date 9th June 2021

Dear Kirsty,

RE: Consultation on Pension Scams: Empowering Trustees and Protecting Members

Surrey County Council (Surrey) welcomes the opportunity to respond to the consultation from the Department of Work and Pensions on Pension Scams: Empowering Trustees and Protecting Members.

Surrey is the Administering Authority for the Surrey Pension Fund (the Fund) as part of the Local Government Pension Scheme (LGPS). The Fund has assets of over £5billion and over 300 employers.

Surrey Pension Fund (the Fund) believes that the consultation introduces welcome improvements, but it also misses an opportunity. The preamble acknowledges that a significant amount of pension fraud (at least 5% of transfers) occurs but this overlooks the following.

(1) Diligent pension administrators prevent a lot of scams that are not recorded.

(2) Many scams are not immediately apparent and it may not be until years after the transfer, or even at retirement, that the transferee discovers that some or all of their money has disappeared. In short, many pension scams are undetected and ticking quietly.

The Fund acknowledges that HMRC tightened the supervision on new pension schemes following the consultation in 2016, , but it thinks that it is still not sufficiently robust. The Fund believes that too many questionable pension schemes are navigating HMRC's set up requirements. It is convinced that prevention is better than cure and there is no substitute for tightening the requirements for establishing new pension schemes and ensuring that only fit and proper people can do so. In the Fund's opinion, any review that overlooks introducing tighter scrutiny for new pension schemes is insufficient and unlikely to succeed in significantly reducing scams.

The cost of scams is huge, whether it be in terms of life savings stolen, taxes that will never be paid, the costs of compensating defrauded members or the emotional shock of adjusting to a diminished retirement. The Fund believes that HMRC should ensure that new pension schemes meet stringent requirements in order to spare pension administrators discord with their customers (transferees are often incensed by interventions designed to protect their interests) and the costs of policing pension scams. The Fund disagrees with the following statement in the consultation; *"…it should be noted that the additional impact of operational costs on businesses, where activity is required to comply with the regulations, has not been raised with us during our frequent and intensive discussions with industry groups. In fact, the converse is true as it has been suggested that the regulations can act as a guideline for trustees regarding effective due diligence and may potentially avoid nugatory work or activities".*

The Fund would like to anchor its views to a concrete example (Mrs H v Hampshire). An "HMRC approved occupational scheme" approached a local government administering authority requesting a transfer. The fund in question thought the transaction suspicious but, after performing several checks, it seemed to meet the criteria and the fund felt it had no option but to pay. The arrangement turned out not to be an occupational pension scheme, the transferee subsequently lost (possibly) all the money and Mrs H took her case to the Pensions Ombudsman. The claims company that supported the claim was quoted by the determination; *"why on earth a 59 year old lady, who lives in Portsmouth, would be cashing up a gold plated scheme and joining the money purchase occupational pension scheme of a "steel stockholder" based in Warrington?".* The very existence of multiple claims companies underlines the extent of the problem.

This is an extract from the Pension Ombudsman's determination in the Mrs H v Hampshire case, which highlighted the need to establish that members transferring to occupational schemes have earnings (currently any earnings) in order to be eligible to transfer.

> *"Mrs H was approaching her normal retirement age and was living on the south coast, but the employer running the Scheme was a steel stockholding company and based several hundred miles away. Also, the scheme was recently established. In that situation, one would have expected the Council to make an attempt, by phone or e-mail, to explain its concerns and to point out the possibility that the Scheme could be a scam".*

> *"Mrs H had not opted to join the fund in 1989, even though it was a generous defined benefit arrangement offering a pension and life assurance benefits. It was not until 2002 that she elected to join the fund. This meant that when she left the fund in 2007 her accrued rights were much smaller than they would otherwise have been. This strongly suggests that she was not financially aware and was susceptible to being taken advantage of."*

Pension funds are disappointed that they are often being asked to pick up the bill when it appears obvious that schemes might be a scam from the outset. It invites the question why did HMRC approve this "occupational" pension scheme in the first place? An occupational pension scheme is defined as *"A scheme set up by an employer to provide retirement benefits for its employees. Occupational pension schemes are regulated by the Pensions Regulator*".

The general inference seems to be that administrators should not put too much store in HMRC approval, a scheme may not be what it purports to be (it was not an occupational pension scheme) and administrators may have to compensate transferees if the people operating HMRC approved schemes abscond with the member's money. One step HMRC could consider would be to prevent occupational schemes domiciled in the UK accepting transfers, by withholding listing, until the arrangement has paid its first levy to the Pension Protection Fund.

First condition

Q1. Please provide details of any additional types of receiving scheme to which transfers should proceed without additional checks, including how they can be identified for the purposes of the regulations.

From a local government perspective, the Draft regulations appear to have covered the public sector post-2013 CARE schemes; *"3(3)(a) a scheme for persons in public service as established under the Public Service Pensions Act 2013"* - but not the pure pre-1st April 2014 final salary pension benefits, most of which flow from the Superannuation Act 1972.

The Fund cannot think of a good reason for not including the pure pre-2014/2015 schemes in the regulations as many will lose their final salary protection upon a transfer of any complexion, because it is likely that they will have had a break in membership of a public sector pension scheme of at least five years. However, a possible countervailing argument might be that pure pre-2014 members (who tend to be older) may be entitled to unreduced pensions at age 60.

Second and third conditions

Q2. To what extent is the evidence requirement set out in the regulations to demonstrate an 'employment link' enough and how could it be strengthened?

The Fund welcomes the requirement to demonstrate an employment link and the requirement to prove that both the employer and employee have made contribution to the scheme. However, regulation 4(3)(c) cross refers to regulation *"5(5) For the purposes of regulation 4(3)(c), the minimum salary requirement is that the member must have been paid a weekly salary, during the last 3 months, which was at, or above, the lower earnings limit determined under section 5 of the Social Security Contributions and Benefits Act 1992".* This appears restrict occupational pension scheme transfers to members who are earning at least the lower earnings limit (£6,240 p.a. for 2021/2). As the regulations governing earnings appear to be carefully considered, this seems to be deliberate.

The Fund regards the requirement in regulation 5(2) to provide evidence that that the member has made a previous transfer to the same scheme in the twelve months preceding the current transfer as a potential weakness that is open to manipulation, and it would be better if it was omitted. If DWP is wedded to this requirement, it would be better to restrict it to previous transfers that took place under the **new** regulations as, otherwise, the old (weaker) regulations will undermine the new ones for some time to come.

The Fund thinks that regulation 5(4)(a) should stipulate a certified statement from the pension provider showing the employee's and employer's contributions and the dates they were received. A statement produced by the employer does not prove that the contributions recorded were paid over to the provider.

The Fund thinks although the requirement to record the last three months of employment earnings should relate to the three months preceding the transfer, given that the employee is an apparently an active member in an occupational pension scheme [5(4)(a)(i) and 5(4)(b) and (c)].

As constructed, regulation 5(5) does raise equality issues as (atypically) local government employs a large number of part-time women who may be adversely affected. However, low earners still have a statutory right to changes of fund (transfers within local government) and club transfers (transfer within the public sector) and the policy intention is to prevent scams. Would be transferees who earn less than the lower earnings limit are well within their personal Income Tax allowance and unlikely to pay tax or benefit from Income Tax relief - unless they are eligible for tax relief at source (RAS). Moreover, as their earnings are too low to accrue a state pension there is a balance to be struck between protecting employees with limited means, who have little to gain from pension liberation, and equalities issues.

This is a complicated issue, because most scams seem revolve around pension liberation and employees below the lower earnings limit tend to have smaller pensions and may be able to trivially commute their eventual pensions from occupational schemes without paying commissions to third parties when they retire. They may also be more susceptible to crystallising all or part of their pension benefits in order to address short term liquidity issues. The Fund is aware of study which showed that significant numbers low earners with relatively little service applied for flexible retirement, even though their pension benefits would be subject to substantial actuarial reductions, which would (otherwise) have fallen away as they approached normal retirement age (after all, they were reducing their hours or their grade - not leaving employment).

Conversely, the Fund also understands that many low earners in local government are very able people: for example a parent who has taken on caring responsibilities, people who have had a fulfilling career and are filling in time before retirement, people who focus on charitable work and people who are simply not ambitious. However, the earnings rule may reflect a view that there are too many dubious funds out there (existing regulation is a fortress with an open door), low earners may not be as financially savvy and, therefore, unfortunately, administrators end up bearing the costs of policing the industry.

Q3. How could the evidence requirement for 'residency link' work in practice?

The Fund is disappointed that DWP is not prescribing in regulations the evidence required to demonstrate a residency link, apparently because different jurisdictions have different forms of residency documentation and the evidence members will be able to provide will vary. The majority of QROPs go to a handful of jurisdictions and DWP has the whole panoply of government at its disposal, including the unrivalled expertise of the Home Office (residency and immigration status) and HMRC (domicile for tax purposes) and they are better placed than anyone to develop generic regulations/effective statutory guidance. It seems unfair to leave it to pension administrators, who have no expertise in these areas whatsoever, to muddle their way through without clear guidance and inevitably making mistakes along the way. There is no pressure on DWP to get it right as it will not cost them anything to wait until pension administrators and the Pension Ombudsman gradually iron out the problems by trial and error. In the Fund's opinion, DWP should invest in developing effective regulations rather than relying on pension funds to develop processes that work and compensate the victims of errors (scams).

The Fund regards the alternative requirement (regulation 5[2]) to provide evidence that that the member has made a previous transfer to the same scheme in the twelve months preceding the current transfer as a potential weakness that is open to manipulation, and it would be better if it was omitted. If DWP is wedded to this requirement, it would be better to restrict it to previous transfers that took place under **new** regulations as, otherwise, the old (weaker) regulations will undermine the new ones for some time to come.

Q4. How should the 'red flags' as set out in the regulations work in practice?

The red and amber flags are a particular concern of pension administrators. A layman might assume that a transferee would welcome the good intentions of pension administrators trying to protect their interests; however, this is a complete misunderstanding of the psychology at work. The reality is that many transferees have often built a close relationship with the person driving their transfer (their friend) and pension administrators are simply regarded as busy bodies standing between them and the lump sum they are "entitled" to (their enemy). They are more inclined to believe the person facilitating their transfer and distrust pension administrators to the point where they are prepared to give misleading and, on occasion, untruthful answers to key questions. Indeed, it is possible that some facilitators feed their transferees suitable answers.

This problem is nicely illustrated by transferees with funds of over £30,000 who are required to take specialist financial advice. In the Fund's experience, the adviser almost always counsels against transferring out of a public sector pension scheme and the transferee almost invariably ignores them.

The above observations are critical because red flags in 8(4)(d), (e) and (f) can only work if the transferee provides honest answers. An administrator only knows what the transferee tells them.

> *"(d) the member's request to make the transfer was made further to unsolicited contact about making a transfer from a party previously unknown to the member;*
>
> *(e) the member has been offered an incentive to make the transfer; or*
>
> *(f) the member has been pressured to make the transfer quickly."*

Q5. How should the 'amber flags' as set out in the regulations work in practice?

The amber flags place additional burdens on pension administrators at the worst possible time. The Fund is not convinced that local government pension administrators ever had the skillsets to apply amber flags properly at any time, and there has been an unprecedented exodus of experience in the last ten years. The problem would be even worse in unfunded schemes.

In the Fund's opinion, apart from 8(5)(e), the amber flags are better matched to the skillset of a financial advisor than a pension administrator. It ventures to suggest that pension administrators who are able handle 8(5)(a) to (d) competently will not be working in local government/pension administration for long. The chances are that even with 8(5)(e), there will be too few examples in a particular scheme for an administrator to identify a pattern - unless it is a prolific scammer.

> *"(a) there are high risk or unregulated investments included in the receiving scheme;*
>
> *(b) there are unclear or high fees being charged by the receiving scheme;*
>
> *(c) the investment structures of the receiving scheme are unclear, complex or unorthodox;*
>
> *(d) the receiving scheme includes overseas investments or an overseas adviser has advised the member in relation to such investments; or*
>
> *(e) the trustees or managers of the transferring scheme are aware of a high volume of requests to make a transfer from their scheme either to a single receiving scheme, or involving a single adviser or firm of advisers, or both."*

In the Fund's view, DWP's expectations are too high and pension administrators are being placed in a difficult position. There is tremendous pressure on administrators and transferees and their facilitators become very vocal very quickly if there is any delay. If they identify an amber flag when one is not present, they have delayed/prevented a lawful transfer. If they miss an amber flag, there is no statutory entitlement to a transfer and the fund will have to reinstate the scammed member's pension benefits and bear an eye watering loss.

Q6. Do you have any views on how the requirement to take guidance can work in practice when the pension saver has already taken financial advice?

The Fund is mindful that Freedom and Choice transfers of more than £30,000 are required to take specialist financial advice costing several thousand pounds, but they are not required to follow it. In the Fund's experience, this has led to the absurd position where most advisers counsel against transferring out of a public sector pension scheme, but many members transfer anyway.

The Fund understands that the MaPs guidance will be quite different from financial advice as it is designed to alert members to scams and, presumably, it will focus on amber flags (although it says red and amber flags in the consultation). The Fund feels that the format of the meeting and the details of the evidence required need to be fleshed out as it is difficult to envisage how it would work in practice.

Although DWP would like the information to be proportionate as they do not wish to see members unfairly burdened with excessive information requests or penalised for failure to meet these requests. Nonetheless the Fund believes there should be a requirement that the member's answers should be supported by adequate evidence as experience suggests that, in an incentivised situation, they may not always be candid.

Q7. Annex 3 sets out the proposed list of standard questions that trustees and schemes managers should use to help determine the presence of red or amber flags. Do these questions provide a comprehensive list, which if any questions are not needed and what other questions should be included?

The Fund agrees with the LGA's response to this question, which is rehearsed immediately below.

"• Paragraph 51 assumes that trustees or managers know, when a member requests a statement of entitlement, the destination to which the member is considering transferring their pension scheme benefits. If this is the case, it is easy to determine which questions are relevant to the destination. However, in our experience this is not how the transfer process works. A member requests a statement of entitlement and it is only when the transfer forms are returned (with all the necessary evidence, certification etc) that the trustees or managers know the final destination. If the standard questions in Annex 3 are not included with the statement of entitlement, this will cause delays to an already a lengthy process. We believe the questions in Annex 3 should be included with the statement of entitlement together with a flow chart indicating when they should be completed. This approach will then simply expand on the existing transfer process.

• Whilst the content of the questions is appropriate, we suggest that they are restructured in order to elicit a positive response from the member (as opposed to a simple 'yes/no'), as follows:

• *Question 2 assumes that the person who advised or recommended the member to transfer is the same person as referenced in question 1. This might not be the case. We suggest inserting an additional question to identify this point.*

• *Question 2 suggest changing to 'How were you initially approached to request a transfer?' and give examples including 'your employer'.*

• *Question 3 suggest remove 'If already known'. If we include 'your employer' at Q2 then the member must know who approached them about the transfer.*

• *Question 5 suggest changing to 'Were you offered an incentive to transfer? For example…' that way an incentive not on the list might be forthcoming.*

• *Question 6 suggest changing to 'How will your money be invested? For example…' this will ensure that the member asks the receiving scheme the right question and must elicit a response.*

• *Question 6 does not address the prescription draft regulations 8(5)(a), (c) or (d) concerning whether the investments are high risk or unregulated, the structures are unclear, complex or unorthodox and whether there are overseas investments. We suggest inserting additional questions to identify these points.*

• *Question 8 suggest changing to 'What are the costs and charges for your new arrangement? For example…' this will ensure that the member asks the receiving scheme the right question and must elicit a response.*

• *Question 9(d) the outcome is the wrong way around. The question asks if it is the first time the member has dealt with the advisor/firm, yet the answer states if 'yes' please provide details of your previous relationship when there wasn't a previous relationship."*

Conclusion

The paragraph in the preamble concerning the regulatory approach says that it *"strives to achieve a balance between providing greater protection for pension savers, giving trustees and scheme managers greater power to act in their members' best interests and continuing to give savers the right to exercise choice over how to use their pension savings".* The third aspiration has the biggest impact on pension regulation and, as long as there is enough capacity, the Fund thinks that the emphasis should be on having fewer good quality providers rather than a cornucopia of mixed quality providers, including some poor ones. The Fund thinks that the proposals put forward in this consultation would be much more effective if they were coupled with tighter requirements for setting up a new pension scheme.

The Fund accepts that pension regulation will have to evolve to keep pace with scammers and the Fund advocates a holistic approach. It believes that the rules governing the admission of new HMRC approved pension schemes should be tightened in concert with empowering pension administrators. A partnership is the only viable way forward and we are concerned that DWP has unrealistic expectations of pension administrators.

Yours sincerely

Anna D'Alessandro
Director of Corporate Finance

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