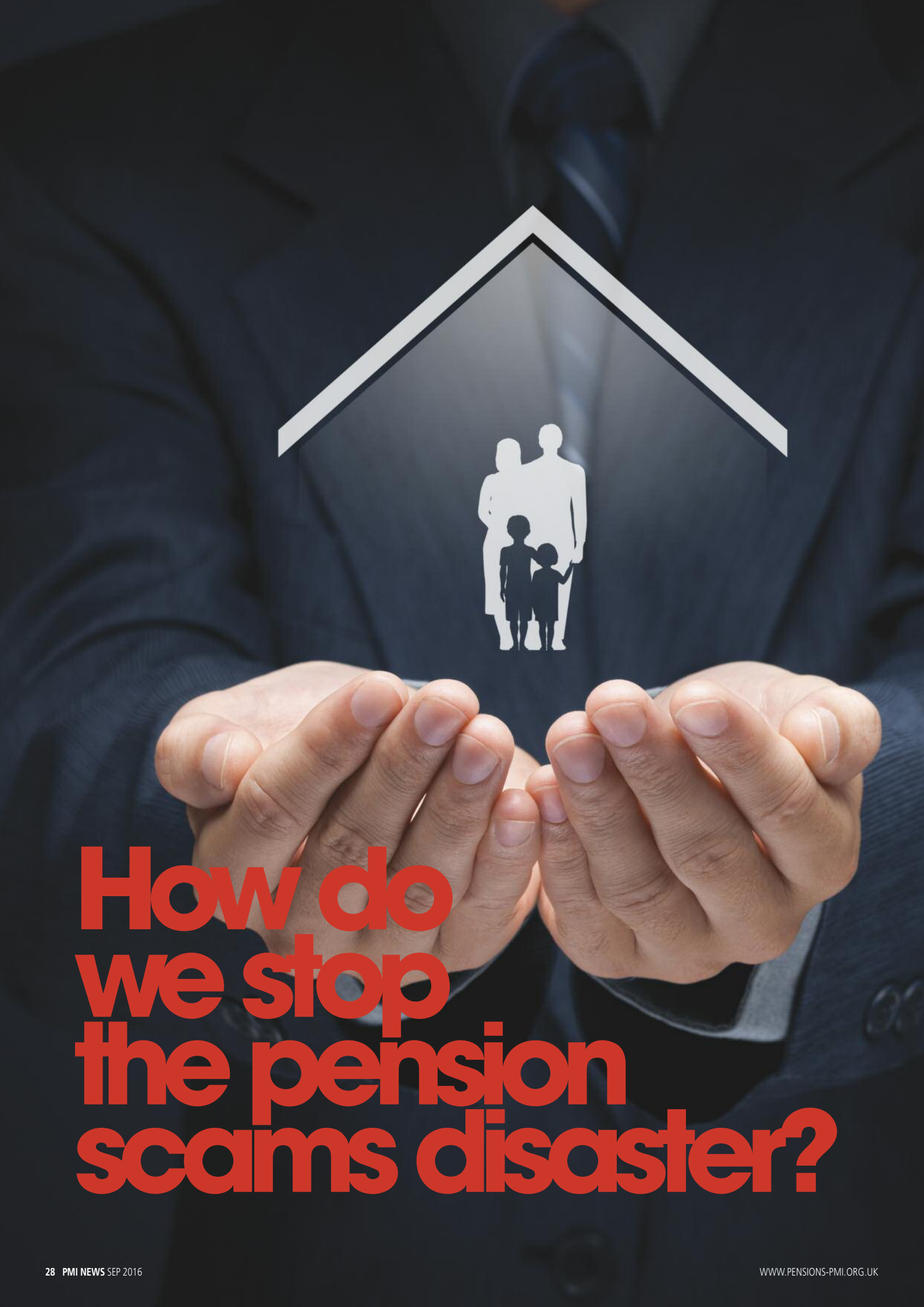

How do we stop the pension scams disaster?

The pension scams disaster continues apace. The public may be more aware of the scams than they were. But the unwary are still being lured into electing CETV transfers to vehicles which offer eye-catching returns but deliver jaw-dropping losses. Legislative changes are needed as trustees now have limited ways to protect members and themselves.

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Pension scheme trustees and others in the industry are torn between two separate objectives. One is to minimise risk for trustees: the risk of not being discharged because a transfer to a scamming vehicle does not discharge their cash equivalent transfer value (CETV) obligation or otherwise opens them up to a charge of maladministration. The other is simply paternalistic: trustees do not want their members to suffer at the hands of the con-artists. Activity to combat scams isn't just about making pension scheme administration safe for the schemes. It is about keeping members safe from the scammers too.

Protecting members from the scammers

Let's take the members first. We don't live in a nanny state, and no one would want us to. Grown-ups can take grown-up decisions, and taking risks in the transfer market is one of them, just like deciding to opt-out of pension provision in the first place. But nonetheless, in financial services especially, we expect regulators to regulate; and that means so far as possible keeping the dishonest and the grossly unqualified out of the park.

So the recent direction of the decisions of the Pensions Ombudsman and the High Court has been a little surprising. *Hughes v Royal London* concerned a CETV transfer request by a member to a scheme about which the Royal London had doubts, having followed the sort of due diligence exercise recommended by the Industry Code of Good Practice, *Combating Pension Scams*. The Ombudsman decided that the proposed receiving scheme *was* an 'occupational pension scheme' capable of taking a transfer for CETV discharge purposes (itself a bold decision: more on that later) but that Ms Hughes had no CETV right because she was not an 'earner' in relation to it (she had earnings, but not from the employer in relation to the occupational pension scheme proposing to receive the transfer).

Ms Hughes appealed to the High Court. Surprisingly, perhaps, the judge decided that she was an 'earner' – it didn't matter, he said, where the earnings came from. So one defence against the scammed transfer has been removed. You can no longer decline to make a transfer on the grounds that the member has no earnings from an employer in relation to the proposed receiving scheme, and in deciding this the judge was perhaps unwittingly removing a useful defence, albeit an artificial one, against the scamming transfer, which the Ombudsman had helpfully retained.

Where the Ombudsman had been bold was in deciding that the scheme was an occupational pension scheme at all. We don't know what he looked at, or how he assessed the facts, but he stated that he was taking as his starting point an assumption that the scheme was not a sham – i.e. an arrangement set up with fine-sounding legal documents as window-dressing but where the true purpose was not to provide benefits for employees as a result of pensionable service at all. It is reasonable to suppose that most scamming vehicles will actually be shams in this way. So assuming that a proposed receiving scheme is not a sham is an odd way to go about deciding if the receiving scheme is an occupational pension scheme capable of receiving a transfer (it follows an earlier High Court decision, which however was making the assumption for more limited purposes and which left it open that an inquiry into the scheme might subsequently show it to be a sham). ▶

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So where does that leave us? Here it seems: in a place where the Ombudsman will order a CETV transfer to be made, even though the transferring scheme has responsibly and diligently followed the process outlined in the Industry Code and encouraged by the Pensions Regulator and retains doubts about whether the receiving scheme is legitimate.

Protecting trustees from claims that they shouldn't have made transfers

Let's go back to the trustees and the risks they run. Where does this case leave them? The biggest danger, it seems to me, is that even where a thorough due diligence process demonstrates that the receiving scheme was created by someone who knew what the boxes were and how to tick them, the scheme might still be a sham. In that situation it will not, despite appearances, be an occupational pension scheme, and the trustees will not be discharged from their duty to provide benefits by making the transfer. The member (or perhaps more likely, his or her spouse or dependant) might come back and claim benefits on the grounds that the transfer ought not to have been made.

> Trustees can manage this risk, but not completely

Trustees can manage this risk, but not completely. They can ask the member to sign a discharge form. It will be better if this does not just confirm that the member is happy for the transfer to be made, but goes further and promises (on behalf of his or her estate) to indemnify the scheme against any losses resulting from a claim by the member's spouse or dependants too. And it is not a bad idea to get the spouse to sign as well.

But ultimately it is not clear that you can force a member to give a discharge like this. If he or she refuses, but asserts the CETV right, the duty to pay the transfer will prevail. The legal CETV right has no strings attached. And you might be criticised if you represent that the transfer will not be made unless the discharge is signed, because this might misrepresent the member's CETV right.

Possible legislative reform and industry initiative

So more is needed. The Department for Work and Pensions (DWP) has indicated a willingness to legislate if a solution can be found; and one very easy reform would be for the CETV right to be lost if the transferring scheme has not established to its reasonable satisfaction that the CETV right exists. Since the pensions freedoms came in in 2015, the CETV right has been lost if the advice requirement is not satisfied, so there is a precedent for this sort of condition being applied. A mere extension of time would not sufficiently protect schemes, because they would be indefinitely stuck with CETV quotes that may become materially out-of-date.

Another welcome legislative reform would be to give a statutory discharge where the trustees reasonably believed that the receiving vehicle was legitimate, but it turned out to be a sham. That can only help trustees in their predicament.

Finally, one attractive idea would be for the industry to set up some sort of pooled due diligence co-operative. The due diligence encouraged by the Code of Good Practice is time-consuming and expensive. If instead a unit were formed to do it on a collective basis, economies of scale would apply. Indeed, if there were one central due diligence unit that practically everyone was using, it would become necessary for receiving schemes wanting to take transfers to get themselves cleared – and in practice that would put the burden of proof on the receiving schemes, not the poor transferring schemes. The receiving schemes can be asked to pay charges to cover their clearance. That is only fair, since these days the vast majority of transfers, even where wholly legitimate, are to schemes established with a commercial motive. There is no harm in making them do the legwork to demonstrate their bona fides.