SQUIRE PATTON BOGGS

New Rules on Pension Transfers – Urgent Action Required

UK – November 2021

New regulations[1] coming into force on 30 November 2021 change the conditions applying to a member's statutory right to take a cash equivalent transfer value (a "statutory transfer"). The changes have been introduced to help protect members from pension scams and will impact occupational and personal pension schemes in the public and private sectors.

Significant changes have been made to the regulations since the draft regulations were issued for consultation in May. This leaves the pensions industry playing "catch-up". Trustees and managers of pension schemes (referred to in this publication as "trustees", in the interests of simplicity) will have to act quickly to incorporate the new requirements into their existing processes for transferring members' benefits, ready for when the regulations take effect.

The DWP's response to consultation states: "[The Pension Scams Industry Group] estimate there being no likely scam risk in 95% of transfer requests. The policy intention is that trustees do not need to conduct additional due diligence in these cases." This seems optimistic given the severe consequences that members and schemes can face if the trustees fail to spot and prevent a pension scam. There has also been a significant increase in the volume of complaints from members about transfers in recent years, often aided by claims management companies. The stakes are high and many trustees will naturally be wary of making a wrong judgement call. To demonstrate compliance with the new requirements existing transfer processes will need to be reviewed and updated – trustees are likely to err on the side of caution when determining the extent of the additional checks and safeguards required.

The new regulations introduce a series of steps into the statutory transfer process, which require judgements from the trustees of the transferring scheme. A key issue for discussion and agreement will be the interaction between trustees and those responsible for the day-to-day administration of the scheme, and the extent of delegation.

Large third-party administrators will no doubt form views on how the new transfer processes should work and will make proposals to the trustees. The trustees will need to understand and be comfortable with those proposals – compliance with the regulations is ultimately their responsibility. Trustees should also expect additional transfer questions to be referred to them for consideration and should plan how these can be dealt with efficiently.

Overview of the New Transfer Process

In simple terms, the new regulations provide that a statutory transfer can only proceed if the trustees decide that one of two conditions is met. These conditions are referred to in the regulations as the First Condition and the Second Condition.

The **First Condition** will be met if the trustees have satisfied themselves "beyond reasonable doubt" that the transfer is to one of the following:

- A public service pension scheme that meets specified criteria
- A Master Trust scheme authorised and listed by The Pensions Regulator (TPR)
- A collective money purchase scheme authorised and listed by TPR

Note that the draft regulations previously issued for consultation in May included within this list schemes operated by insurers registered and authorised by the Financial Conduct Authority (FCA) and authorised by the Prudential Regulatory Authority. However, these provisions were amended and transfers to these schemes will not now satisfy the First Condition.

In establishing whether the First Condition is met, the trustees must not ask the member for information or evidence beyond that necessary to identify the correct receiving scheme. Transfers that meet the First Condition should, therefore, be able to proceed without delay.

The **Second Condition** is more complicated. In brief, in deciding whether this condition is met, the trustees will need to assess whether there are particular circumstances that could indicate there is a risk of pension scam activity.

[1] The Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021 (which extend to England, Wales and Scotland).

In specified scenarios, which are viewed as high risk, a "red flag" will apply. If a red flag is present, the Second Condition is not met and the transfer cannot proceed.

In other specified circumstances, which may indicate an increased risk of pension scam activity, an "amber flag" will apply. Where an amber flag is present, the transfer can only proceed if the member provides evidence that they have taken specific scam guidance from the Money and Pensions Service (MaPS).This standalone requirement to attend a MaPS guidance session applies even if the member has taken separate financial advice on the transfer. If the member does not provide the necessary evidence that the MaPS guidance has been received then a red flag applies, the Second Condition is not met and the transfer cannot proceed. If the member does provide the evidence of receiving the MaPS guidance and still wishes to go ahead with the transfer, the trustees should record that decision and can proceed with the transfer.

If the receiving scheme is not an occupational pension scheme (OPS) or a qualifying recognised overseas pension scheme (QROPS), the trustees can decide that the Second Condition is met without requesting additional evidence or information from the member, provided that they have already carried out sufficient due diligence to decide "on the balance of probabilities" that no flags are present. In its new guidance on dealing with transfer requests, TPR anticipates that trustees may wish to keep records of low-risk pension schemes (often referred to as a "clean list") for this purpose. If the trustees are not satisfied that no flags are present then further due diligence will be necessary and the regulations enable the trustees to request additional evidence or information from the member.

If the receiving scheme is an OPS (and not a QROPS) then the trustees must request additional evidence from the member to demonstrate that there is an "employment link" between the member and the receiving scheme. Specified criteria must be met in order for there to be an employment link, including that the member's employer must be a sponsoring employer of the receiving scheme and the member's employment must meet minimum salary requirements.

If the receiving scheme is a QROPS, then evidence must be requested from the member to establish a "residency link" (broadly that the member is resident in the country or territory in which the QROPs is established), or either an employment link or a residency link if the QROPS is also an OPS.

The regulations set out the evidence that must be provided by the member to demonstrate the employment link or residency link. The TPR guidance provides further information on how these requirements will operate in practice. If the trustees consider that the member has provided insufficient evidence to demonstrate an employment link or a residency link (as applicable), an amber flag will apply. The member will, therefore, have to provide evidence that they have taken the scam guidance from MaPS before the transfer can proceed.

The regulations list other scenarios where amber flags are raised and the statutory transfer cannot proceed unless the member provides evidence that they have obtained the MaPS guidance.

We set out below an overview of the circumstances that can trigger a red or amber flag.

Red and Amber Flags

Note that, in the interests of brevity, we have only provided high-level descriptions. We have not captured all of the complexities of the legislation or the standard of proof that the trustees require before they can raise a red or amber flag. Further explanatory information, to help trustees navigate these complexities, is provided in TPR's guidance on dealing with transfer requests.

Red Flags
The member has failed to provide a "substantive response" to a request for evidence or information in respect of the Second Condition.
The member is required to obtain MaPS guidance as an amber flag is present, but has not produced the necessary evidence of having done so.
Someone has carried on a regulated activity for the member in respect of the transfer, without the appropriate regulatory permissions from the FCA.
The member's transfer request has been made following unsolicited contact for the purpose of direct marketing of the transfer.
The member has been offered an incentive to make the transfer (the legislation excludes certain incentives offered by the trustees or sponsoring employers of the transferring scheme).
The member has been, or considers that that they have felt, pressured to make the transfer.

Amber Flags
The member has provided a "substantive response" to a request for evidence or information, but the response is incomplete.
The trustees decide that evidence provided in response to a request for evidence or information may not be genuine or may not have been provided directly by the member.
The member has provided all of the evidence or information requested (in connection with a transfer to an OPS or QROPS) but it does not demonstrate the relevant employment link or residency link.
The trustees decide that there are high risk or unregulated investments included in the receiving scheme.
The trustees decide that there are unclear or high fees being charged by the receiving scheme.
The trustees decide that the structure of investments included in the receiving scheme is unclear, complex or unorthodox.
The trustees decide that there are overseas investments included in the receiving scheme.
The trustees decide that there has been a sharp or unusual rise in the volume of requests to transfer to the receiving scheme and/or involving the same adviser.

Note that circumstances leading to an amber flag include where the trustees have reason to believe that the receiving scheme has high risk or unregulated investments; unclear or high fees; or unclear, complex or unorthodox investment structures. The legislation defines terms such as "high risk", "high fees" and "unorthodox" by reference to what is considered normal in the current financial market, based on the trustees' knowledge of that market. In reality, many trustees will need help to ascertain whether the amber flags apply. We expect that most trustees will take the lead from their administrators and advisers, but the trustees need to understand the guidance provided and ask questions where appropriate, as they are ultimately responsible for making the relevant judgement calls.

Suggested Actions for Trustees (Some Are More Obvious Than Others)

- Most importantly, trustees need to be reacting to the new regulations and requirements without delay. This cannot wait until the next trustee meeting! There is just a matter of weeks to prepare for the changes. TPR's recently published guidance on dealing with transfer requests is recommended reading for trustees who wish to get up to speed with the new regime.
- Speak to scheme administrators and advisers to better understand the impact of the regulations on the scheme and confirm that the scheme's transfer processes will comply with the regulations when they come into force. Discuss with advisers the various judgement calls regarding when amber and red flags are triggered. Confirm whether the changes will result in additional costs or delays in processing transfer requests.
- Assess whether the existing checks and procedures to identify pension scam activity are robust enough. This goes wider than just ensuring that the requirements set out in the new regulations are met. For example, the regulations only apply to statutory transfers; do the processes for actioning non-statutory transfer requests include equivalent checks and balances? Note that TPR has stated in its guidance "Our expectation is that trustees will carry out enough due diligence on a non-statutory transfer to be confident that they have fulfilled their fiduciary duties to the transferring member".
- Where it is necessary to collect extra information from members, ensure that this is done in compliance with the requirements of data protection legislation. For example, the member will need to have sufficient information to understand why the information is being requested, how it will be used, who it will be shared with and the consequences of failing to provide it. The trustees should also consider how long that information will be retained for.
- Update member communications regarding transfers. Under the regulations, trustees are required to provide additional information to the transferring member within set time frames. It may also be useful to have standard documentation that can be used to request additional evidence from members who have requested a transfer, for example, where evidence is needed to demonstrate an employment link or residency link. TPR emphasises the importance of effective communication in its guidance and makes a number of recommendations regarding the information that should be provided.
- Review and update information made available to members concerning transfers, such as in scheme booklets or on scheme websites. Consider actively communicating the changes to transfer procedures to the wider scheme membership and/or to individuals who have already expressed an interest in transferring their benefits. This will help manage expectations going forward and provides another opportunity to bring the dangers associated with pension scams to members' attention.

- TPR recommends that trustees ask the member to confirm once they have booked an appointment with MaPS, so that the trustees can check whether they will be able to meet the statutory deadline for making the transfer. We endorse this recommendation as we anticipate that demand for MaPS appointments will be high, particularly when the regulations are first introduced. Consensus across the industry will be developing and many trustees will err on the side of caution when deciding whether to raise an amber flag, thereby requiring the member to seek MaPS guidance.
- Assess whether enough support is given to transferring members who are vulnerable. TPR flags in its guidance that trustees should "be aware of member vulnerability" and identifies resources that trustees can refer to for further information.

It might be tempting to rely on the DWP's assertion that the new regulations will only impact 5% of transfers and assume that third-party administrators will already be doing everything they need to in order to prevent members from falling victim to a scam. However, the new regulations place responsibility squarely on trustees and if something goes wrong, the cost to the member and the scheme could be significant. Trustees should act now to ensure that their schemes will be able to comply with the new transfer rules by the 30 November deadline.

Contacts

If you would like to discuss any of the issues set out in this communication, please get in touch with your usual Squire Patton Boggs contact or any of the individuals below.

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