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Proposals to Tackle the Threat of Pension Scams

The DWP and HM Treasury have issued a joint consultation on the options for combatting pension scams which continue to blight the world of pensions. Recognising that a magic pill does not exist, the consultation proposes a number of measures including banning cold calling in relation to pensions, restricting members' right to a statutory transfer and making it harder for fraudsters to set up small pension schemes.

The consultation runs until 13 February 2017.

Background

For many people in the UK their pension savings will be their largest financial asset. The amounts invested in pension savings means they have proved an attractive target for fraudsters over the years. In early 2015 the government established Project Bloom, a joint task-force which it hoped would be able to tackle pension scams. Led by the National Crime Agency, the task-force includes the Department for Work and Pensions, the Pensions Regulator, the Financial Conduct Authority, HM Revenue & Customs, the Serious Fraud Office and the National Fraud Intelligence Bureau.

Successes were unfortunately limited as the fraudsters were able to generally stay one step ahead of the authorities. The introduction of the pension freedoms in 2015 has if anything, seen an increase in fraudulent activity with fraudsters trying to dupe members into partaking in high risk, unregulated investments.

Thus two years after launching Project Bloom the government has now accepted that more needs to be done and is consulting on a range of new proposals.

What is a pension scam?

Pension scams take a number of different forms. Traditionally pension scams have commonly been aimed at members who had not yet reached their normal minimum pension age (usually age 55). Members were fraudulently encouraged to transfer their pension into arrangements set up under the pretext of obtaining cash, tax-free, ahead of normal minimum pension age. Any member caught doing this, innocently or not, became subject to unauthorised payment tax charges of up to 55% on the whole of the benefit transferred, whether or not they had received the full amount or a reduced amount due to the fraudsters "fees". Trustees or providers of the transferring scheme could also unwittingly become liable to a scheme sanction charge.

The pension freedoms have led to an increase in pension scheme members being encouraged to invest in unregulated investments, particularly investments associated with overseas property or natural resources. Even in cases where these overseas investments are legitimate, members are often given unrealistic expectations of the likely returns and the liquidity of such investments, and do not realise how high risk such investments are.

To recognise this shift in the focus of the scammers, the authorities are therefore proposing to redefine pension scams as:

"The marketing of products and arrangements and successful or unsuccessful attempts by a party (the "scammer") to:

- release funds from an HMRC registered pension scheme, often resulting in a tax charge that is normally not anticipated by the member
- persuade individuals over the age of 55 to flexibly access their pension savings in order to invest in inappropriate investments
- persuade individuals under 55 to transfer their pension savings in order to invest in inappropriate investments

where the scammer has misled the individual in relation to the nature of, or risks attached to, the purported investment(s), or their appropriateness for that individual investor."

The consultation asks if this definition captures all the key areas of pension scams.

Comment

While the proposed definition certainly seeks to recognise the evolving focus of the pension scammers, some questions remain. These include:

1. Would members recognise when the release of funds would result in a tax charge becoming due?
2. The term "inappropriate investment" is somewhat subjective. Should this not refer instead to something like "high risk, unregulated investments"?
3. Shouldn't the third bullet point apply to all members, rather than just those who are under age 55?

Signs of a Scam

The consultation identifies the techniques used to perpetuate pension scams as including:

- high pressure sales tactics, including cold calling;
- attempts to discredit the individual's existing arrangement;
- ignoring or claiming to have dealt with the tax consequences;
- promises of 'guaranteed' high returns;
- descriptions that do not properly portray the risks of the investments;
- overseas investments that lack local regulation or compensation if things go wrong.

The consultation asks if there are any other factors which should be considered as signs of pension scams.

Cold Calling

Members may be targeted by scammers through websites, mass texting or through cold calls, with cold calling being by far the most common method used. While the Financial Conduct Authority, the Information Commissioner's Office (ICO) and Ofcom all have limited powers to regulate cold calls, they do not have the power to introduce a total ban.

The government is proposing to pass legislation to introduce a complete ban on cold calling in relation to pensions. This will not stop fraudsters breaking the law or calling from outside the UK. However a blanket ban will hopefully send a message that no legitimate organisation will ever cold call members about their pensions. The government is also proposing to give the ICO the power to fine firms operating in the UK up to £500,000 if the ban is breached.

The ban is intended to catch various types of pension scams including "free pension reviews" and misleading offers of high returns on pension funds.

It is not intended to prevent legitimate advisers who have an existing client relationship with the person concerned or where a member of the public requests information from a firm. There appears to be a question mark over situations where an existing client relationship might exist which is based upon a cold call made in the run up to the ban, and the government will need to be mindful of action the scammers take in advance of the cold calling ban coming into force.

The consultation asks whether the ban on cold calling telephone calls should be extended to electronic communication such as e-mails or text messages.

Comment

In addition to free pension reviews, advice or guidance, it would be worth the government also considering bans on these services where they are provided for some nominal amount, or at a substantial discount, as this would seem to be an obvious way to get around the ban.

It is difficult to understand why the government is only minded to ban cold calling via telephone calls, and possibly extending this to e-mails and text messages. Why not all communications, including letters and social media, such as Linked In (a known method by which scammers attempt to contact members)?

Limiting the Right to Statutory Transfers

One of the problems facing trustees and administrators when they suspect a transfer may not be legitimate is that members have a statutory right to a transfer. Mere suspicion without absolute proof is often not enough in the face of a member determined to make the transfer.

The consultation is thus proposing to limit an individual's right to a statutory transfer to cases where:

- the receiving scheme is a personal pension scheme operated by an FCA authorised firm or entity
- a genuine employment link to the receiving occupational pension scheme could be demonstrated, with evidence of regular earnings from that employment and confirmation that the employer has agreed to participate in the receiving scheme; or
- the receiving occupational pension scheme was an authorised master trust.

While the proposal would mean that members did not have a statutory right to make a transfer in all cases, trustees would still have a discretion (in accordance with scheme rules) to allow a non-statutory transfer and would be expected to use that discretion if the receiving arrangement did not appear to be a scam.

Re-establishing the need for proving a genuine employment link with the sponsoring employer of the receiving arrangement (and thus reversing the 2016 High Court decision in Donna-Marie Hughes v Royal London), would place the onus on the member making the transfer to prove its legitimacy. The consultation does recognise that proving a regular earnings link might be difficult in some circumstances such as for those self-employed or working on zero hours contracts. It has thus made an alternative suggestion in the consultation to the effect that "insistent" members could be asked to sign a declaration similar to the "discharge letter" set out in the Industry code of practice on combatting pension scams. Such a letter would limit the recourse the member had to a claim against the transferring scheme.

Whether by accident or design, qualifying recognised overseas pension schemes (QROPS) would not appear to fall within the definition of what is a statutory transfer, and on the face of it under the consultation would all be treated as discretionary transfers. If this is deliberate, and with HMRC continuing to maintain that inclusion on their list of recognised overseas pension schemes (ROPS) is not proof that an overseas scheme meets the ROPS requirements, and that the onus is on trustees to establish an overseas scheme is a ROPS, the moment such a transfer is discretionary many trustees may simply refuse to make transfers to QROPS.

Comment

Where a genuine employment link needs to be evidenced, the requirement for "regular earnings" could be seen as subjective. We would hope that HMRC will provide guidance on exactly what can be considered to be "regular earnings".

Establishing Small Pension Schemes

Pension schemes wishing to benefit from tax reliefs must register with HMRC for tax purposes. Many fraudsters have used Small Self-Administered Schemes (SSASs) for pension scams. Prior to 6 April 2006, SSASs had to appoint a professional trustee known as a pensioneer trustee. The removal of this requirement has not helped with a significant increase in the number of SSASs used for fraudulent activity, with many such schemes being increasingly marketed as products offering exotic investments and unrealistic returns. Although the consultation falls short of suggesting the reintroduction of pensioneer trustees, it does propose making it harder for SSASs to be registered with HMRC by ensuring only active (i.e. non-dormant) companies can be used for scheme registrations. Thus the practice of setting up a shell company which never trades to allow for the creation of a one member SSAS will be brought to an end.

Comment

The consultation suggests that a dormant company is one that has been registered with Companies House but is not carrying on any business activity or receiving any form of income, such that HMRC considers it dormant for corporation tax purposes. This raises the question about how HMRC would be satisfied that a company is dormant. If it were to rely upon Companies House data, then this would be retrospective, and could still give scammers a window of opportunity to use a dormant company as a sponsoring employer.

Respondents to the consultation are asked whether there are any other actions that the government should consider to prevent SSASs being used as vehicles for pension scams. It is not difficult to envisage many requests to see the reintroduction of pensioneer trustees.

In Conclusion

We welcome this consultation and support its main proposals. They go a long way towards addressing pension scams in their current form and thus helping trustees and administrators catch up with the tactics being used by fraudsters at this time.

One problem, which frequently affects areas of pension policy, is the apparent disconnect between the DWP and HMRC. For the proposals contained in this consultation to work effectively, the industry will need both areas of government to work together. Thankfully, with the consultation being co-sponsored by the DWP and HM Treasury, this should provide some hope of a coordinated government approach to tackling the scammers.

There are still some obvious loopholes, for example the impossibility of policing cold calls being made from outside the UK. Presumably the obvious lack of detail on QROPS – frequently used by scammers - is a deliberate decision by the government. We also note the continuing denial by the government that the HMRC registration process should be seen as any sort of "approval" of the legitimacy of a scheme. It seems to us self-evident that greater due diligence at the HMRC registration for tax purposes would make it harder for scam schemes to slip through, and it is unrealistic for HMRC to wash their hands of any responsibility for weeding out fraudsters.

That aside, the government has at last started to take note of what the pensions industry has been telling them for years and shown a willingness where necessary to pass primary legislation to combat this national issue. These proposals in this consultation are not going to stop fraudsters but, for an industry which was beginning to feel they were being expected to tackle the problem alone, the consultation comes as some welcome relief.

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