DC Governance Watch

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Transfers

Welcome to this issue of PASA's DC Governance Watch covering the thorny topic of transfers. Here we're looking at the governance aspects trustees and schemes should consider to comply with transfer regulations, while maintaining a degree of pragmatism in delivering an effective service to pension savers.

Pension transfers continue to be a key governance issue for pension schemes and their trustees and this is particularly true for DC transfers. Here people are looking for quick, efficient transfers when they want them. But trustees also need to comply with the recently introduced anti-scamming regulations, designed to limit those same people's susceptibility to scamming. The industry needs an efficient transfer system which recognises safeguards need to be in place to protect savers by providing necessary, but proportionate, friction in the system to help guard against scams.

CONTENTS

1. The new transfer regulations

This issue of DC Governance Watch looks at:

- **these new regulations and why problems are arising with DC transfers**
- **what can trustees and administrators can do while we await greater certainty and clarity from the regulations**

Put simply, the intention behind the transfer condition regulations is to ensure members don't lose their pensions by transferring to scam arrangements.

Previously, issues arose where trustees were legally obliged to make a transfer to a particular arrangement because the member had a right to a statutory transfer. In most instances, trustees had to comply even when they had concerns about the receiving arrangement. The introduction of new anti-scam regulations was designed to correct this anomaly.

2. Drafting issues

Unfortunately, due to issues with the drafting of the transfer condition regulations, trustees now have the opposite problem. A pension saver may wish to transfer to an arrangement the trustees don't view as a scam, but either a red or amber flag has been raised. This is particularly the case where a small incentive is offered in connection with the transfer (which can be interpreted by the letter of the regulations as a red flag which means the transfer can't proceed), or where the receiving scheme includes overseas investments, which will be the case for almost all pension schemes (an amber flag which requires a referral to MoneyHelper).

Alongside the specific drafting issues relating to incentives and overseas investments, there are broader issues for trustees concerning how to implement the regulations and determine whether a flag has been met. For example, deciding whether investments are 'high risk' or if 'high fees' are being charged by the receiving scheme. While the auto enrolment DC charge cap can give some context, identifying a scam can potentially be a far more subjective test than before.

3. Meeting the challenges

The challenge for trustees is how they manage the sometimes competing aims of compliance with the regulations, operating efficient and proportionate administration procedures and ensuring appropriate due diligence to identify scams – all while meeting people's expectations for a timely transfer. People expect DC transfers to be quick and straight forward. This means trustees should look at their scheme's policies and procedures, and streamline them where possible to ensure they're workable and efficient. Initially, they should work with their advisers to set out policies concerning how they'll assess whether amber flags have been triggered. For example, identifying and setting out what constitutes high charges and unorthodox investment structures. To supplement this, governance procedures should clearly state what transfers can be dealt with by the administrators, what cases need to be raised with other advisers (such as lawyers) and when matters need to be raised with trustees.

It's advisable for trustees to carefully consider if and how they should be involved in the process. For larger DC schemes with significant numbers of transfers, it's just not practical for the trustees to be hands-on with every transfer. Therefore, they need to be satisfied the procedures and structures are operating in the correct way, especially how the administrator deals with a 'new' or 'difficult' case when it occurs.

Another important area is the use of clean lists. Once a verification process has been carried out in respect of a receiving scheme, then the list can be used to ensure future transfers to providers and schemes on the list can occur more smoothly. Even if a clean list can't be used as envisaged in the legislation, to limit the necessary due diligence required to be carried out there should as a minimum be a development of procedures with administrators. This will evolve over time but there should be a clear approach to dealing with particular schemes and issues as they reoccur. Trustees and administrators should also be alive the requirement to maintain the clean list as it too will evolve as scammers reinvent themselves on detection.

To ensure the correct balance between protecting pension savings and delivering streamlined administration, the pensions industry and Government need to work together. They need to explore whether greater collaboration between administrators can smooth the process and whether the legislation can be formulated to allow a central/universal clean list to be developed. As DC pension provision matures and people consolidate their pension pots, the number of DC transfers is bound to increase and processes will have to be efficient to cope. Plus, when an IFA is involved they should have a regulatory responsibility to able to demonstrate a receiving product is suitable for the individual. Trustees/employers should be aware of this responsibility if they're providing access to an IFA.

4. Discretionary transfers

Many scheme rules give trustees the ability to make discretionary transfers outside of the statutory framework. Typically, these will have been used in the past in cases where a member didn't have a right to a statutory transfer, such as a DB member transferring out at retirement age. However, this option is currently being pushed into the limelight as a 'fix' for issues with the current drafting of the legislation for DC transfers. Particularly with the red flag triggered by incentives, meaning a statutory transfer can't be made.

The Pensions Regulator (TPR) has opened the door allowing trustees to make use of the discretionary route by updating its guidance stating:

> "After carrying out such due diligence, you may conclude that while a red or amber flag might be triggered, the risk to the member is still low".

This is a helpful reference point for trustees to ask themselves the following question: 'before the transfer regulations came in, after carrying out due diligence, would we have been willing to make a transfer to this particular scheme?' For instance, before the transfer regulations came into existence most trustees would have been comfortable allowing transfers to a legitimate pension scheme providing an incentive to members, such as a small cash payment. The question then is, if trustees were comfortable before, why wouldn't they be comfortable now? Do they view these schemes as providing a new risk to members transferring to them?

Discretionary transfers raise a risk for trustees themselves and they should consider taking legal advice before making a decision to carry out a discretionary transfer in these circumstances. In particular, if they take the discretionary transfer route, they'll need to understand the legal implications of not getting the statutory discharge which would apply under the statutory route. Trustees need to understand whether there's a greater risk of challenge from members.

Trustees should think carefully about using discretionary transfers to address this issue for three reasons:

1. If trustees don't allow a discretionary transfer to an arrangement which isn't a scam, then there's the potential for member complaints. While it intrinsically feels more difficult to challenge trustees for not doing something, compared to a situation where trustees take a wrong action; a successful member challenge can't be ruled out. There's also the time and cost incurred in dealing with a complaint to consider

2. Trustees can potentially take mitigating actions to address the risks posed by making a discretionary decision. They can check whether the scheme rules contain a discharge, and ensure the member transfer consent forms include appropriate discharges. Transfer communications can highlight the particular flag preventing a statutory transfer being made (e.g. the incentive) and asking the member to acknowledge the issue. This reduces the risk of the member later arguing this is a reason for the transfer to be unwound

3. The member may have sound reasons for wanting the particular transfer to be made, such as consolidating pension pots, and allowing the transfer supports their retirement planning

5. To sum up

New regulations need to be drafted to clarify the situation and remove the anomalies created. While guidance from TPR is useful, it doesn't absolve trustees' responsibilities under the law. Many in the industry would also like to see the creation of a central scheme safe list, particularly for DC transfers This would go a long way to removing duplication and cost from the system, giving trustees and administrators certainty where a transfer is clearly and obviously not going to a scammer.

As TPR noted, it's important to take a risk-based approach to decision-making, but this is problematic given the current regulations. Further guidance might help administrators and trustees, and thinking and experience will also no-doubt evolve as time progresses, but this is no substitute for clarification in the regulations.

PASA Annual Conference

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Kim Gubler is a Keynote Speaker at the Professional Pensions Admin & Data Forum, the event will be in London on 15 March 2023. PASA is a Media Supporter for the event and we have a stand, so please pop along and say hi!

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