100 HYMANS # ROBERTSON

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New transfer conditions to tackle scams

In an effort to prevent members from falling victim to scams, new Regulations will prevent trustees or managers of pension schemes from processing statutory transfers unless certain conditions are met.[1] The changes come into effect on 30 November 2021, so scheme administrators have only a little time in which to bring their processes into compliance.

Legislation

Section 125 of the *Pension Schemes Act 2021* allows the Department for Work and Pensions (DWP) to place extra conditions on the exercise of the statutory right to transfer. It will be brought into force on 30 November 2021.[2] The meat of the matter is contained in the *Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021*, which also come into force on 30 November 2021.[3] They apply to any application for a defined benefit (DB) statement of entitlement (guaranteed cash equivalent transfer value), or request to transfer money purchase rights, which is made on or after that date.

Policy developments

The DWP conducted a consultation exercise on draft Regulations from May to June 2021. It has made substantial changes to the arrangement of the legislation in response to the comments garnered. Whereas the preliminary version of the statutory instrument would have required trustees to satisfy themselves that one of four conditions was met before a transfer could proceed, the finalized Regulations establish just two distinct bases: either (1) the transfer destination is in the public sector, or is subject to regulatory oversight; or (2) the transfer circumstances raise no '*red flags*'. However, the development has been to the organization of the legislation rather than the underlying policy, as the two surviving conditions cover essentially the same ground as the four that were put forward for consultation.

First Condition: fast-tracked transfer to low-risk scheme

If the transferring trustees can satisfy themselves beyond reasonable doubt either that the receiving scheme is a UK public-service pension scheme, or that it appears on the Pensions Regulator's list of authorized master trust (MT) or collective money purchase (CMP) schemes, the First Condition is met, and the transfer can proceed. The trustees must

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[1] The *Occupational and Personal Pension Schemes (Conditions for Transfers) Regulations 2021* (SI 2021 No. 1237).
[2] The *Pension Schemes Act 2021 (Commencement No. 4) Regulations 2021* (SI 2021 No. 1236).
[3] SI 2021 No. 1237.

establish the scheme's credentials themselves; the most they can require from the member are the details necessary to identify the correct receiving scheme.

In the consultation proposals, transfers to schemes (other than MT or CMP schemes) run by authorized insurers would also have been green-lit. The DWP says in its report on the outcome of the consultation exercise that it removed this option after complaints that it would create an uneven playing field for different types of provider authorized by the Financial Conduct Authority (FCA).[4] All such transfers will now go ahead (or not) under the Second Condition, where the DWP expects that the majority will proceed without additional due diligence.

Second Condition: red and amber flags

Transfers to personal pension schemes, and all occupational schemes not covered by the First Condition, will have to meet the Second Condition, which looks for the presence of some 'red flags' characteristic of scams. The listed red flags are:

- the member failing to provide a 'substantive response' to requests for evidence or information;
- the member failing to produce the required proof that he or she underwent guidance from Money and Pensions Service (MaPS) when the trustees required it because of the presence of one or more amber flags (see below); and
- the involvement of someone who engaged in regulated activity without having the required permission or exemption, transfer requests in response to unsolicited direct marketing, dangled incentives (such as free pension reviews, promises of early access to funds, savings advances or cashback), and transfers made under pressure.

Trustees must request specified evidence of an employment link when the transfer destination is an occupational scheme (other than those covered by the First Condition), and evidence of a residency link when the destination is a qualifying recognized overseas pension scheme (QROPS). Trustees will have discretion to request other evidence or information about the circumstances of the transfer to enable them to decide whether red or amber flags are present. In most cases, the evidence must be provided directly by the member to the trustees.

If the trustees conclude that an amber flag has been raised, they will have to require that the member undertakes MaPS guidance, and the transfer cannot proceed unless the member provides proof of compliance (the DWP says that the MaPS will supply 'unique identifiers' to members who have completed the guidance). The amber flags are:

- incomplete responses to requests for evidence or information;
- provision of evidence or information that may not be genuine or appears to have been spoon-fed to the member;
- inconclusive evidence of the employment or residency link; and,
- a rag-bag of scam hallmarks, such as high-risk or unregulated investments; unclear or high fees; unclear, complex or unorthodox investment structures; overseas investments; and suspicious transfer activity involving the same receiving scheme or adviser.

Procedure

The Regulations lay out the standards of proof that trustees must apply when making decisions based on the available evidence. They also make it clear that trustees need not restrict their considerations to information supplied by the member: the consultation outcome report suggests, for example, that they could compile and use a list of schemes that due diligence has shown to present a low scam risk.

Trustees will have to inform the member about the conditions for transfer within one month of an application for a DB statement of entitlement or transfer request (unless the transfer is made before that deadline). Notice of a decision that a condition is satisfied must be given no later than the confirmation that the transfer has been made. If the decision is that neither condition is satisfied, notice must be given within seven working days.

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[4] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/986183/pension-scams-empowering-trustees-and-protecting-members.pdf>.

Guidance

The Pensions Regulator has published guidance on the new transfer diligence obligations.[5]

The new conditions for transfers should give trustees more discretion to block suspicious requests, but the legislation remains complex, and the lead time afforded for necessary system changes is very short. Varying degrees of certainty are prescribed for different tests—'*beyond reasonable doubt*', '*on the balance of probabilities*', or just '*reason to believe*'—introducing subjectivity and increasing the chances of inconsistent application. The rationale for decisions may need to be carefully documented to reduce the risks of a successful challenge.

Climate & investment reporting: setting expectations & empowering savers

The Department for Work and Pensions (DWP) proposes to amend the climate-change governance and reporting regulations to require trustees and managers to calculate and disclose a 'portfolio alignment metric' setting out the extent to which trustees' investments are aligned with the 'Paris' goal: limiting the increase in the global average temperature to 1.5 ºC above pre-industrial levels. It is also consulting on draft guidance, both statutory and non-statutory, concerning implementation statements, and best practice in relation to Statements of Investment Principles (SIPs).

Portfolio Alignment Metric

Background

New climate risk governance and reporting requirements came into effect for trustees and managers of large occupational pension schemes from 1 October 2021. Schemes with relevant assets worth £5 billion or more on the first scheme year-end date which falls on or after 1 March 2020 (together with authorised master trusts and collective money purchase schemes) must (for example) select and apply at least three metrics for their scheme—one an absolute measure of emissions, one an intensity-based measure of emissions, and one additional climate-related metric.[6]

From 1 October 2022, the requirements will be expanded to cover occupational pension schemes with relevant assets of £1 billion or more.

Proposals

The DWP is proposing to amend the above obligations, from 1 October 2022, to require trustees to calculate and disclose a portfolio alignment metric. This metric would set out the extent to which scheme investments are aligned with the Paris agreement target of limiting the increase in the global average temperature to 1.5ºC above pre-industrial levels. This metric is currently listed as an optional metric for trustees to use in their TCFD reporting, but under the DWP's proposal would become a mandatory fourth metric.

Portfolio alignment metrics could include simple measurements such as the proportion of a portfolio where companies have put in place science-based, emissions-reduction targets. Alternatively, they could be more complex measurements such as the 'implied temperature increase' of a portfolio, assuming that policies and strategies are borne out.

The new requirement will apply to all trustees subject to the Regulations on and from 1 October 2022, and trustees will have to report against the new metric within seven months of the end of the scheme year which is underway on that date. Since the new requirement will come into force during a scheme year for some schemes already in scope, it will apply to the part of the scheme year that begins on 1 October 2022. The current easement in the Regulations will be extended to allow such schemes to rely on data obtained, calculations performed, and identification and assessment of climate-related risks and opportunities undertaken during that same scheme year, but before 1 October 2022.

Schemes that have already chosen a portfolio alignment metric as one of the three required from 1 October 2021 will need to select an additional metric to use from 1 October 2022 to remain compliant with the legislation. The amended guidance will remove portfolio alignment metrics from the recommended list for the additional metric and add six new options from the TCFD's updated recommendations.

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[5] <www.thepensionsregulator.gov.uk/en/pension-scams/dealing-with-transfer-requests>.

[6] For more details see our 60 Second News Summary, *Government response to consultation on TFCD Regulations for pension schemes*, <www.hymans.co.uk/insights/research-and-publications/publication/sixty-second-summary-government-response-to-consultation-on-tcfd-regulations-for-pension-schemes>.

Draft stewardship guidance

The consultation also contains draft non-statutory guidance on best practice in relation to statements of investment principles (SIPs) and statutory guidance on the Government's expectations for implementation statements (ISs).

Trustees of occupational pension schemes with 100 or more members are required to publish their policy on the exercise of the rights attaching to the investments, and on undertaking engagement activities in respect of those investments. This is done in the SIP. Trustees are also required to report how, and the extent to which, they have followed this policy, as well as on significant votes cast, via an annual published IS. Money purchase schemes and hybrid schemes with money purchase sections are required to publish an implementation statement covering the full range of policies in their SIPs.

The DWP states that the draft guidance '*focuses on the areas where existing policies and reporting appear to be weakest—stewardship and, to a lesser extent, consideration of financially material ESG factors and non-financial factors.*'

The (non-statutory) SIP guidance reminds trustees that they must either set their own voting policy or acknowledge responsibility for the voting policies that asset managers implement on their behalf. It encourages them to identify their scheme's stewardship priorities, and publish their policy on voting and engagement (or that of their investment managers, if that is what they rely on).

The (statutory) implementation guidance suggests, among other things, that trustees should report on the extent to which voting carried out on behalf of the scheme reflects the policies that they have adopted. For the purpose of collecting information on significant voting decisions made by a third party, the Pension and Lifetime Savings Association's vote-reporting template is given as an example of a useful resource.

There is no date given on which the guidance is intended to come in to force, but the consultation document states that the DWP will '*revisit the extent to which this Guidance is being followed and has helped trustees understand expectations around the SIP and IS—or whether a regulatory intervention is necessary—in the second half of 2023.*'

The consultation period runs from 21 October to 19 December, 2021.

De minimis fund for flat-fee default charges

The Department for Work and Pensions (DWP) has announced the outcome of a consultation exercise about *Permitted Charges within Defined Contribution Pension Schemes*.[7] It will proceed with plans to introduce a *de minimis* fund size for flat fees within the charge-capping rules, so as to prevent such fees from reducing the value of a member's funds held in auto-enrolment default investment arrangements to less than £100. Amendment Regulations and non-statutory guidance will be published in time to implement the change from April 2022.

Background

A charge cap applies to the default investment arrangements for money purchase benefits in schemes used for compliance with the automatic enrolment rules. The standard cap is set at 0.75 per cent per annum of the value of the member's rights, and applies when only a fund-value-based charge is employed. However, the legislation permits other charging structures, in which a lower fund-value-based charge is combined with either a flat fee or a per-contribution charge.

The DWP conducted its consultation exercise from 24 May to 16 July 2021, having become concerned about the application of flat fees to small, deferred pension pots that are subject to combination charging structures.[8]

Consultation outcome

The *de minimis* will be set at a 'default arrangement' pot size of £100, initially (it will be kept under review), and will apply to active and deferred members. The timing of default-fund valuations will be addressed in a revised version of the non-statutory guidance, *The Charge Cap: Guidance for Trustees and Managers of Occupational Schemes*, which will recommend monthly or annual intervals, and that flat fees are deducted on the day of the valuation.

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[7] <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1032154/permitted-charges-within-dc-pension-schemes-response.pdf>.

[8] For a summary of the consultation proposals, see *Current Issues* June 2021 <www.hymans.co.uk/media/uploads/Current_Issues_-_June_2021.pdf>.

The Government says that it will redraft its amending legislation to make it clearer that, in cases in which the flat fee, if levied in its entirety, would reduce the value held in the default arrangement to less than £100, a proportion of the fee can still be charged, provided that it does not reduce the value below £100. It will also allow providers to refund any excess charges resulting from multiple applications of the flat fee within the same valuation period.

The May 2021 consultation document also sought feedback on a proposal to abolish combination-charge structures, from a date yet to be determined, so that the only permitted arrangement would be a percentage annual management charge. The DWP now says that it plans to take more time to consider the evidence for and against moving to a single charging structure for defaults before making any policy decisions.

Lastly, the DWP says that it is committed to supporting consolidation, and is working with the cross-industry Small Pots Co-ordination Group, which recently issued a progress report on the work that has been done to develop practical solutions to the proliferation of small deferred pension pots.[9]

We are pleased that the DWP remains committed to protecting small pots from erosion by investment charges. However, we believe that the *de minimis* value should have been higher than £100, and therefore agree with the plan to review the effectiveness of the protection that it affords. We remain concerned that administration and provider teams will have little time, following the finalization of legislation, in which to implement the necessary changes. We support the development of processes to protect members and deliver improved outcomes through consolidation of small pension pots, and await with interest the DWP's conclusions on a universal charging structure.

DWP proposes >100% increases in fraud levy rates

The Department for Work and Pensions (DWP) proposes to increase the fraud compensation levy from 75p (30p for defined contribution master trusts) per member to £1.80 (65p for DC master trusts) per member, with effect from the 2022/23 levy year.[10] It says that the increase is required to recover (by 2030/31) the anticipated costs of claims related to scam pension schemes, following a November 2020 High Court judgment.

Background

In broad terms, the Fraud Compensation Fund (FCF) was set up to provide recompense to occupational pension schemes with insolvent employers that have suffered a reduction in assets attributable to crime. The clearest example is where someone connected with the ailing sponsor of a genuine scheme has misappropriated pension scheme funds.

It was unclear whether the FCF could apply when the scheme itself was an integral part of the ruse to defraud members, and both its supposed sponsor and original trustees are thoroughly complicit. The Pension Protection Fund (PPF), which runs the FCF, and a professional independent trustee company that has been appointed by the Pensions Regulator to take over numerous such schemes went to court to seek clarification of the principles that would determine whether and by how much it is able to compensate 'occupational pension schemes' set up as vehicles for scam transfers.[11] The judge preferred broad interpretations of who counts as a scheme employer, what might constitute an employer's pension liabilities under the scheme, and the sorts of 'loss' that could be attributed to an offence. His findings were welcomed by the PPF.[12]

Shortfall

The DWP estimates that the FCF faces £250m in costs from claims by 122 former pensions liberation fraud schemes, following the judgment.

The consultation period ends on 10 December 2021.

The FCF is now being adapted for a novel purpose, which is why the levy needs to go up. Examples of fraud compensation have hitherto been few and far between, because the required confluence of events—embezzlement at the

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[9] *Co-ordination Group Making Good Headway On Small Pots Solution* (September 2021) <www.plsa.co.uk/Press-Centre/Press-Releases/Article/Co-Ordination-Group-making-good-headway-on-small-pots-solution>.

[10] *Review of the Fraud Compensation Levy Ceiling* (November 2021) <assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1029910/consultation-on-the-review-of-the-fraud-compensation-levy-ceiling.pdf>.

[11] *The Board of the Pension Protection Fund v Dalriada Trustees Limited* [2020] EWHC 2960 (Ch).

[12] <www.ppf.co.uk/news/fraud-compensation-fund-eligibility-criteria-confirmed>.

same time as insolvency—has been mercifully uncommon. Indeed, the levy was not imposed at all for several years, beginning in 2012/13, because the FCF's finances were so healthy and there were so few claimants on the horizon. In 2017/18 it was charged at 25p per member, and held at that level until the PPF ratcheted its 2021/22 levy up as high as it would go (ignoring the discount for master-trusts, which are relatively low-risk) in response to the court ruling. So the costs of cleaning up after transfer scams are falling on the pensions industry, but may in some cases be passed on to members via higher charges.

Treasury closes NMPA change window

The *Finance Bill 2021/22* has been published.[13] It includes a provision that would redefine the phrase '*normal minimum pension age*' (NMPA) in the pensions tax legislation, so that from April 2028 onward it would mean age 57.[14] There has been a significant change to the transitional rules associated with the change.

The NMPA is the earliest age at which members of tax-registered pension schemes can access their benefits, other than in circumstances of ill health, without triggering unauthorized payment charges. It is currently set at 55 years of age; from 6 April 2006 to 5 April 2010 it was age 50.

The Government plans to raise the NMPA to 57, from 6 April 2028, to keep it in line with increases to State pensionable age. An exception would be made for members of the '*uniformed services*' (for example, the armed forces, the police, and firefighters). As for the 6 April 2010 increase, there would be transitional protections associated with the change, for members of schemes that entitle them to take their benefits before reaching the increased NMPA. In this case, the rules of the scheme as they stood on 11 February 2021 must have given the member the right to access any benefit before age 57.

The transitional protections would also provide those who lacked such rights a short window of opportunity in which they could have obtained them by joining a scheme with a suitable 11 February 2021 rule. Whereas the draft clause published earlier in the year would have given people until 6 April 2023 to join schemes that give them rights to take benefits from age 55, the Bill now says that that window of opportunity closed at midnight on 3 November 2021. Transfers that were already in the pipeline at that time can still proceed and (assuming the receiving scheme meets the conditions) secure a protected pension age for the member. A Written Statement from the Treasury explains that the change was made to address concerns raised about the original proposal.[15] More information on the policy is available in a Tax Information and Impact Note (TIIN).[16]

The Written Statement and TIIN both allude to industry concerns that any transitional provisions that allowed a longer window of opportunity for members to join schemes that gave them a protected pension age could have delivered them into the hands of fraudsters. The revised clause is less susceptible to such abuses, although we suspect that scammers will continue to dangle the lure of early access to ensnare their victims, unless the details of the NMPA change are carefully communicated. Although the new conditions for protection are mercifully simpler than their 2010 antecedents, there remain plenty of issues for trustees to contend with, such as how (or perhaps whether) they will deal with individual transfers received from protected schemes, where the rights that come with the protected pension age would have to be ring-fenced.

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[13] <publications.parliament.uk/pa/bills/cbill/58-02/0184/210184.pdf>.

[14] See clause 10.

[15] <questions-statements.parliament.uk/written-statements/detail/2021-11-04/hcws373>.

[16] <www.gov.uk/government/publications/increasing-normal-minimum-pension-age/increasing-normal-minimum-pension-age>.

Statutory minimum revaluation in deferment

The *Occupational Pensions (Revaluation) Order 2021* confirms that the minimum statutory revaluation of final-salary deferred pensions for those who reach normal pension age in 2022 will be based on the 3.1 per cent rate of Consumer Prices Index (CPI) inflation over the year to September 2021.[17]

The statutory revaluation calculation depends upon the number of complete years in the period between leaving pensionable service and reaching normal pension age. The increase for the most-recent, one-year revaluation period is based upon the Secretary of State for Work and Pensions' assessment of the percentage increase in the general level of prices in Great Britain for the year to the 30 September before the Order is made. The Secretary of State can estimate the level of prices '*in such manner as* [s]*he thinks fit*'; currently, the Government's preferred measure is the CPI. The inflationary increase is capped at 5 per cent for pensions accrued in respect of pensionable service up to 5 April 2009, and at 2.5 per cent for subsequent accrual. Since annual CPI inflation was 3.1 per cent in September 2021, the single-year revaluation percentage for pre-6.4.2009 benefits will be 3.1 per cent, whilst for post-5.4.2009 pensions revaluation will be capped at 2.5 per cent.

The legislation that determines the minimum, annual, statutory increase to pensions in payment picks up the headline inflation figure from the Revaluation Order. Capping applies there too, but the pivotal date is different: where statutory increases apply, the minimum uplift to pensions in respect of pre-6.4.2005 service will be 3.1 per cent in 2022, whereas the increase for post-5.4.2005 pensions will be capped at 2.5 per cent.

State pensions increases

The *Social Security (Up-rating of Benefits) Act 2021* received Royal Assent on 17 November 2021, despite a temporary wobble in the House of Lords. The Act suspends the earnings linkage for State pensions for one year, because of the distortions introduced into the statistics by COVID measures. The House of Commons rejected Lords' amendments that would have retained the earnings link but allowed the Government to use an earnings-increase figure adjusted to remove those distortions. However, the Government had misgivings about its ability to find a sufficiently robust adjustment method; and the House of Lords decided not to push the issue any further. The effect is that, in April 2022, the Government is required to increase the basic and new State pensions by the higher of 2.5% or the increase in prices.

The Department for Work and Pensions (DWP) subsequently confirmed that the basic State pension will increase to £141.85 per week from April 2022, and the full weekly rate of new State pension will increase to £185.15, based on the 3.1 per cent rate of CPI inflation discussed above.

HMRC newsletters: November 2021

Managing Pensions Schemes Service Newsletter—November 2021

Her Majesty's Revenue and Customs (HMRC) published a November 2021 edition of its *Managing Pensions Schemes Service Newsletter*.[18] It announces, amongst other things, that scheme administrators can now see a 'read only' list of the schemes that they will need to migrate to the MPSS from the legacy Pension Schemes Online service. There is a link to guidance on how to prepare for the migration, and what to do if the list is wrong. There are also reminders that (as mentioned in *Pensions Schemes Newsletter 134*[19]) HMRC is moving to multi-factor authentication for its online services, and that it is looking for volunteers to join its MPSS user panel.

Pension Schemes Newsletter 135

Pension Schemes Newsletter 135 contains (amongst other things) a call for scheme administrators registered on the Pension Schemes Online service, who are no longer acting for any pension schemes or intending to do so in the future, to contact HMRC so that it can delete the relevant credentials.[20] It also reminds scheme administrators who are paying tax due in connection with Accounting for Tax returns to use the relevant charge reference, so that the payment is correctly allocated to the tax charge. On the Managing Pension Schemes service, if an amendment to an AfT return increases the amount due, a new charge reference will be provided for the additional amount.

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[17] SI 2021 No. 1308.
[18] <www.gov.uk/government/publications/managing-pension-schemes-service-newsletter-november-2021/managing-pension-schemes-service-newsletter-november-2021>.
[19] See *Current Issues* November 2021 <www.hymans.co.uk/media/uploads/Current_Issues_-_November_2021.pdf>.
[20] <www.gov.uk/government/publications/pension-schemes-newsletter-135-november-2021/pension-schemes-newsletter-135-november-2021>.

And Finally…

7 Faces of Dr. MaPS

The FCA's latest quarterly rule-change consultation proposes to update its Handbook (recommended reading if you find pensions legislation insufficiently labyrinthine for your tastes) to reflect rebranding by the Money and Pensions Service (MaPS).[21] The MaPS assimilated—yes, resistance was futile—the Money Advice Service, aspects of the Pensions Advisory Service, and Pension Wise. It now presents them to the public under the umbrella of 'MoneyHelper' (it's still 'the Money and Pensions Service' for official purposes, as its Sunday name, and when its mummy wants to shame it for being naughty).

Over in Occupational Pensionsville, also known as The Land That Rebranding Forgot, numerous legislative provisions continue to require that members are directed toward '*the Money and Pensions Service*' for assistance—even when responsibility for providing the help in question now lies with the Pensions Ombudsman's office.

AF feels that one could be forgiven for going full-Morrisette, and finding some flavour of irony about an organization established as the 'single financial guidance body', partly to eliminate confusion, which has had more changes of identity than Ethan Hunt…

[21] CP21/27 <www.fca.org.uk/publication/consultation/cp21-27.pdf>.

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