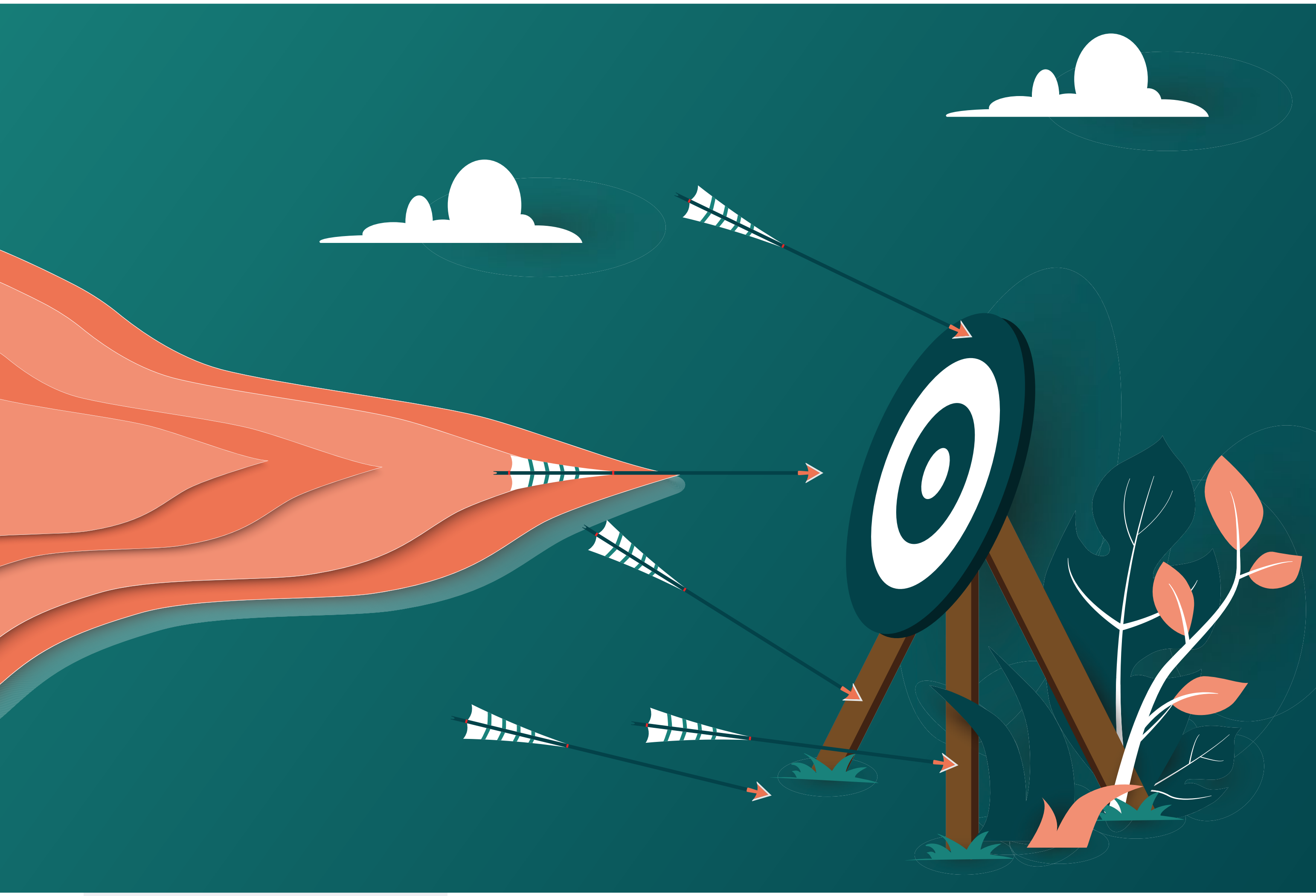


Summary

- The regulations have proved somewhat successful in catching potential scams, but have also delayed legitimate transfers and increased complexity.
- Overseas transfers setting off scam warning flags continue to be the primary source of delays.
- However, the industry has begun to adapt and transfer times have gone down since the regulations were introduced.
- Despite this, industry figures are calling for changes to overseas transfers and incentives rules, as well as clarity on administrative challenges.

Trial and error

Jack Gray investigates the impact anti-scam regulations have had on pension transfers, how the industry has adjusted, and what the sector hopes will come out of the government's review

The pensions industry is more reliant than most on trust from its members, and the scourge of scams can not only rob people of their hard-earned savings, but can also erode this trust and reduce people's faith that their money is safe. To help tackle the issue, the Department for Work and Pensions (DWP) introduced new measures in November 2021 that would enable pension scheme trustees to block transfers that raise scam 'warning flags'.

While the regulations have proved to be successful in reducing pension scams, they have introduced complexity and confusion for the industry. This has led to longer pension transfer times and even disputes among providers, with PensionBee accusing several other providers of abusing the legislation to block or delay customers moving their pensions. The accused providers noted they were following the definitions outlined in the rules as to what would constitute a 'red flag', and the disagreement resulted in the DWP and The Pensions Regulator (TPR) publishing new guidance to try and solve the issue.

However, problems with the regulations remain and, while the industry has gone some way to adapting to the transfer rules, many are calling for the legislation to be adjusted. The DWP recently conducted a review on what changes the sector would like to see, and many hope that rules around overseas transfers and incentives will be addressed to reduce transfer times and complexity.

Paying the price

While commentators acknowledge that the legislation has reduced the level of scam activity around pension transfers as intended, it has also resulted in legitimate transfers being delayed. The rules state that transfers to a receiving scheme that offer the opportunity to invest in overseas assets must raise an 'amber flag', which remains the main bone of contention for those raising concerns about the legislation, while the rule that transfers offering an incentive are red-flagged is also causing friction.

"The rules when applied in the manner they were intended work well at ensuring trustees have the power to stop a transfer that they believe is a scam," comments Broadstone head of policy, David Brooks. "This is really helpful and has definitely been successful in stopping scams.

"Unfortunately, the overarching impact has been a delay to some legitimate transfers, which has created lots of issues in the adviser community and amongst members keen to transfer but are having obstacles in their path.

"This is because a strict interpretation of the regulations has led to some schemes/trustees determining that use of a global equity fund is an overseas transfer and so worthy of a Maps session or an incentive is used meaning the transfer should be red-flagged."

Barnett Waddingham partner and PASA board director, Chris Tagg, agrees: "Security of member benefits has increased, so I would label the exercise a success. At a high level, administrators have grasped the concept and intended outcome of the regulations but, in general, trustees are probably lagging behind in their understanding and willing to make decisions.

"Success has only been achieved through increased complexity since the regulations were introduced, increasing time spent on transfers by both administrators and trustees. As time spent has increased, cost pressure on administrators has also increased, further reducing their margins and meaning additional costs are often being passed onto trustees. One unintended consequence of the regulations has had the biggest impact on administration – amber flags where overseas investments are present."

These concerns around the proportion of pension transfers raising scam warning flags are supported by data from XPS Pensions Group, which shows that over 90 per cent of transfers have raised flags in every month over the past year apart from August 2023, when it was 86 per cent.

Isio head of administration, Girish Menezes, highlights the issues the rules have created for administrators: "There are specific opaque issues around overseas investments and value for money that create uncertainty for administrators who are data processors and require guidelines that are deterministic, rather than needing to apply their own judgement.

"The key impact from the transfer regulations has been a shift in the responsibility for preventing scams from the member to the pension administrator and the trustees. Effective due diligence can take time, which given the guidance timescales for receiving a response before it can be considered an amber flag or red flag, places additional pressure on disclosure deadlines, which can lead to potential liability issues. Pension administration is becoming increasingly complex, with interactions with third-party insurers adding to these concerns."

Adapt and survive

While the legislation can create obstacles and increased transfer times, many providers have adapted, and transfer times have fallen since the regulations were introduced.

Origo CEO, Anthony Rafferty, notes that while there was a clear correlation between the introduction of the legislation and increased transfer times, its Transfer Index shows that most providers have adapted well and have now reduced pension transfer times. "This is good news for consumers," he says. "The pensions industry must now look to its outliers, who typically use slow, paper-based processes, with a view to bringing down pensions transfers times across the board."

Furthermore, despite the negatives around delays and complexity, People's Partnership director of policy, Phil Brown, argues the regulations have put breathing space into the transfer process so an assessment can be taken to see whether, in cases when incentives are offered, it can be determined whether a scheme is bona fide or not and if that member's savings are safe.

"This is an invaluable protection to members, especially those who are subject to advertising from unregulated sources," he continues. "We can see from the latest data that transfer times are coming down. There is clear improvement across the industry but our experience over the past two years tells us that some members are not always making an informed choice based on the information available to them."

Brown also says he welcomes the value for money regulations that are about to be consulted on for workplace pension default funds, and urges regulators to bring these rules in for all pensions immediately.

Referrals being made to trustees from administrators so they can make decisions around amber and red flags are, rightly, complicated, notes Tagg, who emphasises that while a lot of responses come only from professional trustees who have more knowledge and experience of transfers, lay trustees probably do not feel confident in making decisions in this area.

Alternative factors

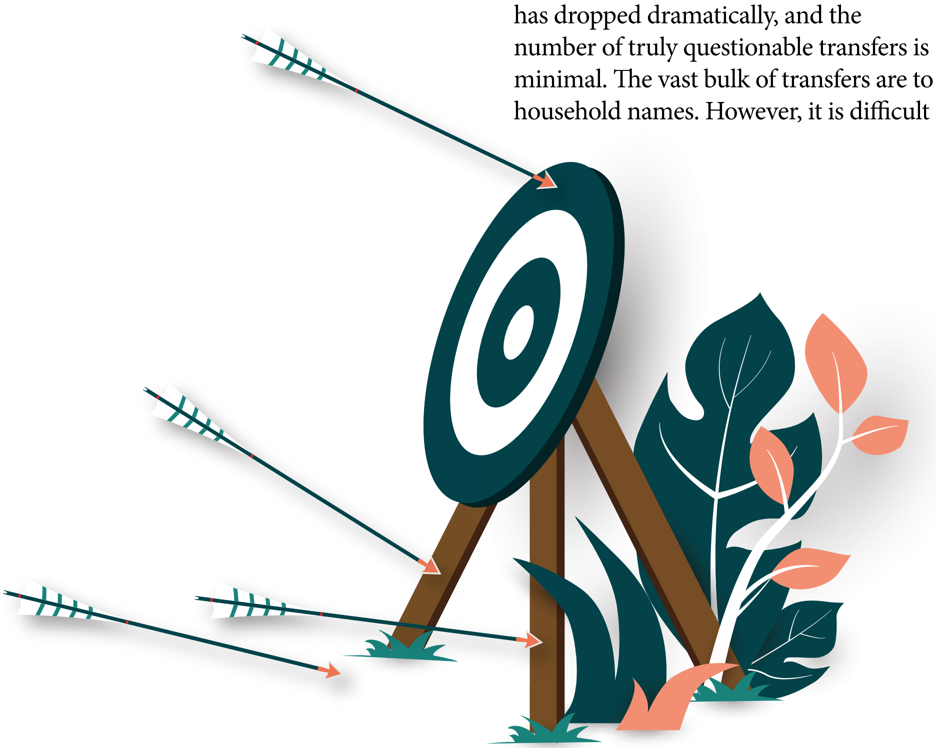
While transfer times have reduced since the legislation was introduced, there may be factors other than industry adaptation at play. XPS Pensions Group Member Engagement Hub client lead, Helen Cavanagh, notes that transfer values are significantly lower than they were two years ago due to the increase in government bond yields over this period.

"We expect this is putting many members off choosing to transfer and July 2023 saw the lowest level of transfer activity since we started monitoring it in 2018," she says. "However, the increase in government bond yields has generated an improvement in annuity rates and so we have seen more members exploring this opportunity."

"We hope that the two key regulations, overseas transfers and incentives, are clarified so legitimate transfers can flow freely"

Tagg agrees, stating that the biggest change since November 2021 has not been regulatory but rather the increase in gilt yields causing transfer values to fall and therefore the number of requests declining.

Menezes adds: "Residency rules around QROPS and changes in gilt yields have meant that the number of transfers has dropped dramatically, and the number of truly questionable transfers is minimal. The vast bulk of transfers are to household names. However, it is difficult to take a view of the effectiveness of the regulations as one can only view a slice of transaction activity, rather than whole-of-market."



Review for change

Due to the widespread industry concerns, the DWP launched a review into transfers and its legislation, and plans to work with TPR and the sector to improve the pension transfer experience.

"We hope that the two key regulations regarding overseas transfers and incentives are clarified so legitimate transfers can flow freely and only the transfers that cause concern should be held up and reviewed," says Brooks.

Cavanagh agrees that the overseas investment flag should be amended, or removed altogether, and believes that other amber flags, such as high charges, should be able to capture the types of overseas investments that would be of concern.

"We also believe that there is scope to expand the amber flags to ensure that they capture emerging scam warning signs," she continues. "Currently, many of the amber flags focus on the receiving scheme and, whilst these are important, we believe that there are other risk areas that should also be flagged.

"For example, there is currently nothing in the regulations that would capture post-transfer scams, where a member is encouraged to transfer their benefits to a legitimate receiving scheme before immediately transferring into a scam arrangement."

From the administrator's perspective, Menezes hopes that more clarity around some of the administrative challenges being faced is provided.

"Whilst it does not look like we will see much in this area this time around, industry groups such as PASA and PSIG are bringing administrators together to share common insights and best practice," he notes.

Written by Jack Gray