PENSIONS AND LIFETIME SAVINGS ASSOCIATION

THE REVIEW OF THE FRAUD COMPENSATION LEVY CEILING

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ABOUT THE PLSA

Our mission is to help everyone achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

We represent the defined benefit, defined contribution, master trust and local authority pension schemes that together provide a retirement income to 20 million savers in the UK and invest £1 trillion in the UK and abroad. Our members also include asset managers, consultants, law firms, fintechs and others who play an influential role in the governance, investment, administration and management of people's financial futures.

EXECUTIVE SUMMARY

- The PLSA fully supports victims of pension scams and shams being fairly compensated as part of our mission of better retirement outcomes for everyone.
- Occupational pension schemes are happy to pay their fair share but that it is right to extend the scope of contributors to other organisations involved in pension provision such as contract-based schemes and advisers.
- The current compensation regime is confusing for savers and industry alike and government should use this opportunity to build a more robust compensation regime that offers protection for all pension savers and is future proofed.
- The 5 months' notice period by government in this consultation is not enough to allow for appropriate business planning to take place.
- The PLSA would like to see a one-year delay in implementing the proposed changes to allow time for a review of where the claims have been generated from and where restitution should be sought from, including contract-based schemes and regulated advisors.
- The current compensation regime is confusing for savers and industry alike and government should use this opportunity to build a more robust compensation regime that offers protection for all pension savers and is future proofed.
- Automatic Enrolment Master Trusts are being asked to pay a disproportionate amount in contributions because of the per member formula and this is especially unfair as they have only existed after claims related to these pension shams and their members are unlikely to be able to claim against the Fraud Compensation Fund under the current rules.
- A review would also allow the per member formula to be looked at, as well as considering a banding system for the largest mass membership schemes and a carve out for small pots of £100 or less.

INTRODUCTION

The PLSA fully supports victims of pension scams being compensated. Our members stand ready to contribute their fair share in paying the outstanding claims through the Fraud Compensation Fund. Our mission is helping everyone to have better retirement outcomes and it is wrong that some people have been defrauded of their life savings.

There is an opportunity to build a more robust compensation regime for all pension savers that looks at both the FCF and Financial Services Compensation Scheme. This opportunity would also allow for future proofing against evolving pension scams and other pension fraud.

We have sought to fully engage with this consultation and to seek solutions to the issues raised. We have met with both DWP and the Pensions Protection Fund team looking after the Fraud Compensation Fund, to raise the concerns of our members and make suggestions about how proposed changes could be improved.

The Fraud Compensation Fund was set up in the wake of the Maxwell pensions scandal to tackle fraud by the employer. Its scope has changed over time with the legislation underpinning its creation being challenged by new pension frauds in the form of pension shams as defined by the High Court.

This consultation only addresses the financial questions raised by outstanding claims without addressing the compensation regime for the saver. It is also clear that if designing the Fraud Compensation Fund today with its current scope, who contributes to it and how much would also be very different.

The High Court decision in PPF v Dalriada Trustees Ltd expanded the remit beyond the original intent which in itself should mean going back to first principles for a full review. The size of claims could be as much as £400 million and the increase in levy contributions ranging from 117% to 140%.

With the size of proposed increases and the impact on business planning, the 5 months' notice between publication of this consultation and expected implementation is too short.

There is a need for at least a year's delay in any increase in the ceiling of the FCF levy contributions to allow for a proper review of the structure and scope of the levy.

The extra year would also allow for an impact analysis to take place looking at the effects of the FCF Levy on running costs for schemes and the knock-on effects for savers. The significant support the Government has made available for the PPF to administer the claims on the FCF, and current industry levies, removes the risk of the Fund having insufficient funds to meet claims in the near future.

The strategic review of the Fraud Compensation Levy could be used to positively help savers by doing the following:

- Linking in with the FCA review of Financial Services Compensation Scheme to build a more robust compensation regime for all pension savers, including the potential for a single entity with responsibility for looking after victims of pensions scams
- Looking to future proof the compensation regime against evolving risk from pension scams or other forms of pension fraud
- Looking to create a broader base of contributors to include contract-based as well as trust-based schemes
- Re-considering the per member formula for the FCF levy to create a formula that works for mass membership Master Trusts
- Considering a banding system as operated by the General Levy or for discounting small pots of £100 or less from calculations

The review should be carried out within the framework of the following principles:

- To place bounds on cross subsidy. Cross subsidy is an inevitable feature of levies and is in some cases desirable. But it should be limited in the following ways:
    - The costs of “greater good” regulation should not fall disproportionately on any one group of levy payers.
    - Schemes should generally fund the regulation of the benefits they offer.
- Distribution of costs should be consistent with government policy for the pensions market. It should not focus on any one market sector. It should not create perverse commercial incentives.

The PLSA notes that gaps in the historic regulatory regime are responsible for making it too easy to register a pension scheme during the timeframe when these pension shams were created. For example, the HMRC registered status of the pension shams was often leveraged by scammers to convince victims of the legitimacy of the scheme.

Finally, we do not accept that there is no need to carry out an impact analysis, as there will be a significant financial impact on pension schemes, especially those with mass memberships and set up for Automatic Enrolment.

CONSULTATION RESPONSE

Question 1
Do you support the proposed change? Please indicate why you support, or do not support the proposed change.

Compensating victims of pension scams is the right thing to do and will help with achieving better retirement outcomes for everyone and protecting the UK pensions system. The PLSA and our members support occupational pension schemes paying their fair share to the Fraud Compensation Fund to compensate the victims of pension shams.

However, we do not support the structure of the changes as they are currently proposed and believe that a year's delay in implementation is needed to carry out a proper review of the Fraud Compensation Fund.

In engaging with this consultation, we have met with the team from DWP and the PPF separately and conveyed our disappointment in the proposals and made recommendations for how to make sure claims are paid to victims and that all parties pay their fair share.

We understand that a loan has been taken out by the Pension Protection Fund from HM Treasury for a period of 10 years and we appreciate that this adds time pressure to reforming the levy structure. We are also cognisant that the loan for £350 million is a credit line that will in effect help to equalise payments made out for claims against revenue generated by the proposed levy increases. There was however no consultation with pension schemes prior to taking on the loan facility and if there had been we would have laid out our concerns and our recommendations.

A one-year delay to allow for a strategic review does not run counter to paying off the loan. Payments of claims could still be made using the loan facility and the incoming existing levy contributions could be used to service the loan during the 2022/23 fiscal year.

Distribution of costs should be consistent with government policy for the pensions market.

The per member levy structure for trust-based schemes also places a disproportionate burden on those schemes with mass membership.

The consultation seeks to raise the ceiling for Master Trusts from 30p per member to 65p per member and for non-Master Trusts, from 75p per member to £1.80 per member. These are significant rises and for some schemes they will have a significant impact on running costs. A five-month window from the publication of this consultation to implementation is not giving enough notice for the financial impact these proposals will cause.

A strategic review would allow for analysis of where pension sham victims were transferred out of, in terms of scheme types. The pension sham victims are just as likely to have been transferred out of contract-based schemes as trust-based schemes. It is also worth noting the 2018 determination by the Pensions Ombudsman against Northumbria Police Pension Scheme that they failed to protect one of their members who had been scammed, and called for them to be reinstated back into the scheme. We are not calling for the source schemes to fully reinstate sham victims, but we do believe that contract-based schemes should pay their fair share of the outstanding claims.

Furthermore, with a delay, there would be time to assess to what extent regulated advisers were involved in any transfer activity. There should also be some consideration to the proportion of claims paid for by the FSCS to cover those cases where regulated advise was given or a regulated activity carried out by a firm.

As mentioned above, we have met with the team at the Pension Protection Fund who are looking after the Fraud Compensation Fund and have faith that they will explore all avenues of restitution prior to settling claims. They are limited in what they can achieve within the boundaries of the current compensation regime, however, and a full structural review of the levy is needed.

The costs of "greater good" regulation should not fall disproportionately on any one group of levy payers.

Time would also allow for an impact assessment to be carried out and in turn for the structure of the levy within the trust-based schemes to be resolved. Currently the per member basis of the Fraud Compensation Fund Levy results in cross subsidy with mass membership scheme with low assets under management paying more on average than other scheme types and more relative to their running costs. A system that introduced banding or a cap for mass membership, as can be seen with the General Levy, could go some way to mitigate this cross subsidy.

Consideration should also be given to the issue of small pots of £100 or less that are often loss making for pension schemes. Carving out small pots from the formula would help Automatic Enrolment schemes in particular, and would make it easier to service those small pots prior to a solution to this systemic issue being found.

HMRC are responsible for the registration of pension schemes and this remains the case. It was far too easy to register a pension scheme at the time the pension shams took place and the industry was consistently calling on tightening up of the process. Being HMRC registered was seen as sign of legitimacy that was often used by pension scammers to give their victims confidence. HMRC have since tightened up their processes for registering pension schemes. In our response to the Work and Pensions Select Committee, we called again for further tightening up of the registration regime for pensions and changes to the rules for Small Self-Administered Pensions, and we still believe this is necessary to prevent future pension scams.

Finally, we would expect to see a long-term commitment set out to build a new more robust compensation regime with the saver in mind. Currently it is possible with some cases to claim compensation from either the Financial Services Compensation Scheme or the FCF, because the level of overlap. Other pension scam victims, particularly where it has been to a QROPS may not be able to claim against any compensation scheme, at least in the UK. The High Court definition of what constitutes a pension sham versus a pension scam would also leave most pension savers perplexed and need a pensions lawyer to clarify. The confusion over where to claim for compensation and in what incidences savers are covered must be fixed.

A review of the compensation regime would also be an opportunity to future proof protection against evolving pension scams and other forms of pension fraud. A long with the commitment the government made to review the pension transfer regulations, we would expect the compensation regime to be similarly reviewed at regular opportunities.

As things stand, the current proposals are unfair on placing a disproportionate share of the cost of compensation claims on Master Trusts that only came into existence after the fraud took place. They also place a burden on surviving schemes amongst trust-based pensions with seeking restitution elsewhere. This level of unfairness should be avoided.

Question 2
What is the impact to your scheme or business of raising the FCL under the proposed change?

The impact of these changes could be to take £400 million out of the occupational pension scheme space and as a result could impact on member charges, value for members, employee benefits packages, and innovation in the industry.

Distribution of costs should not create perverse commercial incentives.

The proposed changes ask one section of the pensions industry to pay for systemic failure that also involves contract-based schemes, regulated advisors, regulators and HMRC. In not at least asking contract-based schemes to pay their fair share, the proposed changes could have the unintended effect of giving them a competitive advantage.

When consulted by the PLSA, our pension fund members were disappointed with the steep increases and the short notice to implementation. With only 5 months' notice between the publication of the consultation and the proposed implementation of the increases, business planning is affected for all.

Non-Master Trust schemes are facing increases of 140% on their levy contributions on top of a previous threefold increase only recently. Master Trusts are facing a 117% increase but because of the per member nature charging formula, the effects on their running costs and business plans have been significant. Noting that some mass membership DB schemes will also face large aggregate costs from the proposed increases.

The costs of "greater good" regulation should not fall disproportionately on any one group of levy payers.

Some of our largest Master Trust members are expected to pay levy contributions in the millions of pounds and this is likely to make up a large proportion of their annual running costs, ranging from £1.3 million to circa £7 million. One of our Master Trusts estimates that the Fraud Compensation Fund Levy could now make up circa 5% of their running costs and is concerned that combined with the costs of other regulatory changes, that they will have to pass on costs to their members.

There is clearly a need to at least take account of mass membership schemes within the trust-based pensions sector and this could take the form of either discounting small pots of £100 or introducing a form of banding or cap for mass membership schemes, as in the General Levy.

The combined effect with other regulatory demands is something that is harder to quantify at this stage but has been mentioned by many of our members, Defined Benefit Schemes, DC Schemes and Master Trusts.

Question 3
How will your scheme respond to an increase in the FCL? For example, would it be absorbed by the scheme, passed on to members, or employers?

All trust-based pension schemes will struggle to meet and effectively change business plans in the five months' notice period given. The time taken up with the increase in levy could be spent on innovation to improve outcomes for members of the schemes.

This comes at a time when trustees are expected to prepare to onboard their schemes onto Pensions Dashboards and factor in TCFD recommendations. DC schemes are expected to change their annual statements to Simple Annual Benefits Statements and DB schemes are busy with GMP equalisation. A one year delay, with a proper review of the levy, would allow all trustees time to properly consider how the FCL increases could be factored into their business planning.

In the case of the largest mass membership schemes, the costs are likely to be passed on to the members. Many of them operate on a not-for-profit basis and are not able to pass on costs to employers in a highly competitive market. This risks having a distorting impact on the AE market.

Schemes should generally fund the regulation of the benefits they offer.

With Multi-employer schemes they are concerned that the Fraud Compensation Levy does not actually give any cover to their members, yet they will have to pass the cost of the levy on to them.

Where schemes have a number of deferred small pots or even active small pots less than £100, they often operate a loss-making service for those members. It is likely that other members in those schemes will be asked to pay the FCF levy costs of the small pots. At least carving out small pots of £100 or less from the formula would mitigate this issue.

Where schemes are able to pass on costs to sponsoring employers, there are concerns that this could ultimately lead to the employer reducing other elements of the employee benefits package such as life cover or not supporting measures to increase pensions adequacy for members in the future.

Some of our pension schemes may be able to absorb the cost where they have more assets under management and lower membership, but the accumulated effects of regulatory change and the short notice period to implementation will still affect them.

DISCLAIMER

Material provided in this publication is meant as general information on matters of interest. This publication is not meant to give accounting, financial, consulting, investment, legal, or any other professional advice.

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