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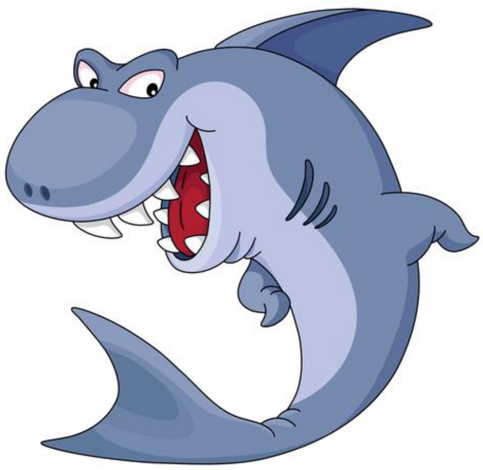
A significant new threat: Pensions Liberation Schemes

13th March 2013



"Hello … could you do with some extra cash: Mortgage problems? University? Car? Holiday?"
"Yes …"
"Have you thought about unlocking your pension?"
"No, I didn't think I could do that. My work scheme doesn't allow it"
"They never do, they do like to keep the money to themselves – keeps them in work! If you transfer it into our pension scheme, we can release it immediately and tax-free. It's all legit and above board, though it will reduce your final pension, of course, and there's a small administration fee."
"What would I need to do?"
"Just write to your scheme and give them our details. They handle all the legwork. Word of warning though: these guys are really slow at processing the paperwork – and we've only got limited capacity. Just drop 'em a line telling them to get a move on …"

Pensions liberation schemes (whether advertised by cold call, email or text message) seem to be on the increase and are causing alarm bells. Pensions tax regulation is clear here: a member is able to receive 25% of accumulated capital back tax-free at the point of retirement but there are extremely

restricted circumstances where an earlier return of capital is anything other than an unauthorised payment. There is also the risk of outright fraud with these schemes and a potential for full loss of the pension pot.

How might the scam work?

The member's work scheme receives notification to transfer funds to a third party pension scheme. The recipient is likely to be representing itself as authorised but may be of small size and may well have been newly formed. The recipient would then shift the money overseas to a non-authorised investment manager. In the "best" case, a significant administration fee will be deducted and some or all of the balance is remitted back to the member as agreed; in the worst case, of course, the money vanishes without trace through laundering. The third party scheme is then likely to be abandoned leaving the member stranded with a large tax liability and a possible headache for the original provider.

Tax liability?

According to HMRC regulations, any unauthorised payment – essentially including almost any repayment before retirement – immediately attracts a 40% tax charge. Additionally if unauthorised payments cumulate to more than 25% of the pension pot in a year, then a further 15% tax surcharge is applied. For completeness, HMRC may also levy a sanction of 15-40% of the payment on the scheme administrator responsible – though it is unlikely that the pension liberation scheme would be looking to pay this!

So, assume David has a £100,000 pot and elects to unwind the whole lot – perhaps in an attempt to clear debts:

- He might pay a 15% administration fee: £15,000 and so receive back £85,000
- However, he might not even know about his 40% charge liability: £40,000
- Or his 15% surcharge liability: £15,000
- So he's likely to net just £30,000 in return for zeroing his pension provision!

Putting this in context, this is just barely more than he could withdraw, tax-free, at the point of retirement, but leaving the residual pot safely invested! The unauthorised tax charges alone could have a very similar tax effect to putting this modest individual into the wealthy bracket: exceeding the lifetime allowance with the consequent 55% levy on lump-sums.

Or of course, he might not see anything returned at all …

Who is advising David?

The brief answer is that no-one is helping him, though plenty of help is available if he knows to look: for instance The Pensions Advisory Service or Action Fraud. The member's work scheme is in a difficult position: leaving to one side reputational issues, no-one wants to see a member scammed and there is obviously a fiduciary duty owed but schemes cannot provide advice and are under an obligation to process transfers to third-party schemes.

Where next?

In order to take a first step to fill this void, the Pensions Regulator has launched an e-learning module and supporting documentation on its website for professionals and administrators – it's fair to say that there are also very accessible to interested members – highlighting the problem and suggested approaches to engage with it:

- Member education – including a briefing leaflet which could be circulated alongside existing communications
- Spotting targeted members and key signs of pensions liberation fraud in transfer requests
- Contacting the targeted member with suggestions as to where to learn more and to receive key advice

The principles and support are a significant step forward but do have some of the feel of the first stage historic anti-money laundering principles before more robust legislation was later brought in.

Schemes can look to adding a process aimed to checking these key signs to the transfer checklist but, as we don't currently have access to useful centralised information about individual recipient schemes, checks are likely to be piecemeal: FSA, Companies House, checking the scheme address for reasonability. In the absence of investigatory agencies sharing information, this approach is likely to remain rather piecemeal.

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Veasey Associates is a business trading name used by Martin Veasey.

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