Written evidence from the Transparency Taskforce [PPS0073]

Work and Pensions Select Committee Inquiry: Pension Scams

Additional Submission by the Transparency Task Force: "Prevention is Better than Cure"

October 13th 2020

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About the Transparency Task Force

The mission of the Transparency Task Force is to promote ongoing reform of the financial sector, so that it serves society better. Our vision is to build a large, influential and highly respected international institution that helps to ensure consumers are treated fairly by the financial sector. The primary beneficiaries of our work will be consumers; but the sector itself will also benefit through improved market conduct and increased trust in the services it provides.

Our objective is to carry out a broad range of activities that help to drive positive, progressive and purposeful finance reform, such as:

- Building a collaborative, campaigning community; the larger it is the more influence it can have in driving the change that is needed
- Raising awareness of issues; so that society better understands the problems that exist in the financial sector and how they can be dealt with
- Engaging with people who can make change happen; because through such dialogue we can influence thinking, policy making and market conduct

Much of our focus is on rebuilding trustworthiness and confidence in financial services. To make this possible we are busy developing a framework for finance reform which we describe as a "whole system solution for a whole-system problem" as described in our recently published book

For further information about the Transparency Task Force see:
http://www.transparencytaskforce.org

The Purpose of this Document

In our main submission, dated September 9th, we detail many problems with the existing strategy and we also set out the many ways in which matters could be improved.

During the Oral Evidence Session of 16th September, the Work and Pensions Select Committee expressed a desire to receive further information about:

- The "Joint Task Force" idea that we proposed; and we provided that additional evidence to the Committee on October 5th
- The "White List" idea that we proposed; which is covered by this document.

This document has been produced by a group of Transparency Task Force volunteers working collaboratively because of their desire to help deal with the UK's significant problem with financial scams, particularly pension scams.

It is not meant as a detailed "instruction manual" on how to develop and implement the "White List" model.

Rather, it merely sets out what we believe to be the inherent advantages of such an approach in an attempt to "get the idea on the table." As such, it is designed as a discussion document, to initiate dialogue amongst all relevant stakeholders including of course scam victims and the many campaign organisations that represent their interests.

We hope that this discussion document will be of value to those with an open mind, particularly those with a "progress begins with realism" mindset i.e. a willingness to accept constructive criticism of the present situation, with a view to fixing what is wrong.

Introduction

This Paper is in two main parts.

Firstly, we cover what we shall describe as a "Product Gateway" which is essentially about helping to prevent products that are not fit for purpose being available in the market.

Secondly, we cover what we shall describe as a "Promotions Gateway" which is essentially about reducing the likelihood of products that are not fit for purpose being promoted. This part speaks to the woeful lack of proactivity by the regulators in closing down scam advertising.

We believe that the combination of both of these approaches would make a very worthwhile contribution to tackling pension (and other financial) scams problems. They are both designed to prevent scams from taking place in the first place; "prevention is better than cure" remains a wise approach to problem solving - prevention is far better than trying to deal with the carnage after the event.

Part 1: The Product Gateway

The Problem

Significant amounts of money are leaking from legitimate, well governed and well-intentioned pension schemes and products, into arrangements which can be significantly detrimental to customers, for example through elaborate and extortionate fee structures, playing fast and loose with customer assets or even outright fraud.

In the past, the concepts of CAT standards, 'White Lists' and 'Black Lists' have been explored as a means of preventing customer assets reaching places of potential harm. However, none has been successful.

In 2001 the Government launched it's 'Stakeholder Pension Scheme'. The scheme came with a CAT standard which was designed to show customers that the product was both safe and represented good value i.e. the CAT standard included a price cap - the C stood for Cost, the A for Access and the T for Terms. A new rule applying to financial advisers (RU64) was introduced by the then Financial Services Authority, which required advisers to demonstrate that where a product other than a Stakeholder Pension was being recommended that the alternative product was better for the customer. Whilst this concept guided legitimate financial advisers to the correct course of action, it would not have prevented those determined to exploit customers from doing so, as there was no fail safe.

From 2013 following the commencement of Auto Enrolment, 'entrepreneurial opportunists' spotted the concept of a Master Trust as a means to bringing customer assets under their control, away from the regulatory protections offered by the Prudential Regulatory Authority, Financial Conduct Authority, the Pensions Regulator and the Financial Services Compensation Scheme.

Early ideas to tackle the problem included 'white lists' and 'black lists'. However, there were two issues here;

- Firstly, putting someone on a 'white list' or a 'black list' is a subjective judgment which can be open to legal challenge. Putting a scheme or a provider on a 'white list' could be interpreted in today's litigation culture as an endorsement and leave those making that judgment open to compensation claims in the future if things go wrong.

- Secondly, without a legal intervention banning the transfer of assets to customers on a 'black list' or only those on a 'white list', scheme trustees and scheme administrators are unable to prevent assets from being transferred to a place of harm, where the customer has been persuaded to insist upon the move. The case of Hughes versus Royal London in 2016 saw Royal London instructed to release the customer's assets to a place of potential harm.

However, the Government did act to ensure that only legitimate, competent and well-intentioned operators were able to operate Master Trusts. The Master Trust Authorisation regime requires Master Trust Operators to demonstrate on an ongoing basis their ability to operate in the best interests of their customers. These include fit and proper persons tests, demonstration of operational resilience, demonstration of financial resilience, investment governance and value for money. With this new accreditation the ‘front door’ was closed to scammers – i.e. money which was inbound into workplace pensions could no longer be directed to places of potential harm.

The problem however remains, that ‘the back door’ remains open. Money accumulated in well governed well protected workplace pensions can be transferred to places of harm too easily.

Considerations for Solution Design

In designing a solution, it is important that the costs of the solution are borne by those who stand to profit from the products or services in question. It is important that the cost and effort associated with a solution be borne by Workplace Pension, Personal Pension, SIPP and Platform operators who would generate income on assets transferred to then. Relying on Regulators, Trustees or Insurance Companies to make judgment calls on which destinations are legitimate, and which might be harmful leaves those entities open to legal challenge and to potential claims for redress in the future which none will be willing or able to bear.

This proposal therefore builds on the concept of the Master Trust Authorisation regime whereby scheme or product operators are required to apply for a ‘license’ to accept money accumulated through a workplace pension. Although the operation of such a licence is something that would need to be considered in some detail, likely components would include;

- Fit and proper persons test
- Operational Resilience including cyber security
- Financial Resilience including compensation arrangements
- Restrictions to a defined list of safe and non-complex investment options
- Availability of governed default investment options with de-risking mechanism towards retirement age and a charge cap – i.e. equivalent to an Auto Enrolment Workplace Pension
- Restrict outbound money to only other schemes and products which also have the licence.

The regime would be operated by an independent body established jointly by the Pensions Regulator and the Financial Conduct Authority. That body would be funded through an industry levy. At present, established and well-intentioned pension providers pay a range of levies. It is likely that the additional cost of managing this license process would be offset by reduced levies elsewhere (fewer scams would very likely lead to a reduction in levies) and also reduced administration costs in dealing with customer complaints.

Having introduced the ‘licence’ a legislative change would be required which prevents trustees and pension providers from transferring assets accumulated in a workplace pension, to any scheme or product operator for whom there is not a current licence. This would prevent vulnerable customers from being pressured to assert their right to have money released into places of suspected harm, where at present the law offers no such protection. Where customers consolidate multiple workplace pension pots into a Personal Pension or Platform which has obtained the licence, then those assets too could only ever be transferred on to other schemes or providers which have the licence, keeping assets within the ‘protected bubble’ for life.

Extended Scope

Wealthier individuals accumulate pension savings outside of workplace pensions in propositions such as SIPPs and Platforms. Some SIPPs in particular offer access to specialist assets which would not be appropriate for workplace pensions and which under these proposals would also be excluded from a proposition holding the license on grounds of complexity. However, it may well be that those holding pension assets outside of workplace pensions are also attracted to the security of a proposition which holds the licence, and those customers should be free to transfer savings from existing pension products to one which has the licence.

Learning from what is being done informally, already - the unofficial bad list

It is a well-guarded secret, many Employee Benefit Consultancies (EBC) and Third Party Administrators (TPAs) who are responsible for the administration of mainly Defined Benefit (DB) and Defined Confined (DC) Trust based arrangements as well as back office services to Master Trusts, maintain informal Bad lists. These lists contain the name of firms they believe to be bogus. As part of a suspicious transfer request, compliance will review the list and alert the Trustees of their concerns.

The details of the suspects are sometimes shared amongst providers but again only informally. There is no formal register held by The Pensions Regulators of firms who are known to operate fraudulently or available to trustees or providers. Not that Trustees are able to prevent a transfer even if they know it is a scam, because of the Hughes v Royal London case.

Learning from others in the industry – Origo's Transfer Service

Origo is a not for profit organisation owned by several large life companies. It sees itself as the ecommerce standards organisation for the life companies.

Origo's Transfer service was created to speed up the transfers of DC pots between life companies and to annuity providers on retirement. It is effectively a hub sitting at the centre of its many life company clients. Where a provider receives a transfer request, they send the transfer request via the hub to the ceding scheme along with a common declaration (wording agreed by those in this transfer club). On receipt of this request and form, the ceding provider sends across the funds and alerts the receiving scheme via the hub.

Origo has created a trusted transfer club. It carries out due diligence on all members of the club and it works based on providers trusting the other members of the club have passed all due diligence. This service recently expanded into the Master Trust space but has yet to gain traction within the Trust based market. Prior to DC freedoms, Employee Benefit Consultants were not able to tell you about the volumes of transfers they were undertaking. However, this changed as they found themselves under administrative pressure due to the sheer volume of transfer requests, but they still resisted joining the club. The excuse used; is that the process in the trust-based world relies upon the ceding scheme providing a Discharge form effectively stating no further liability on them; and each scheme has its own version. Employee Benefit Consultants believe that Boards of Trustees would not move to the Common Declaration form used by the transfer service. This may be a flimsy excuse given the industry adopted another common standard with Straight Through Processing. The legal issues could easily be resolved.

Using this knowledge for the white list

It would be possible to learn from these two examples, amongst others to feed into the creation of the framework for the proposed White List. Clearly, there is a great deal of existing market practice that could be adapted and used to help get the pension scams problem under control.

Conclusion, for Part 1

There is much to be learned from the successful introduction of the Master Trust Assurance Framework that can be applied to help solve the pension scams problem. The Master Trust Assurance Framework was successfully developed by the Pensions Regulator and the Institute of Chartered Accountants in England and Wales. It is helping to protect consumers interests by helping to ensure that their pension savings are held in arrangements that meet certain criteria.

Pension providers that want to operate in the auto enrolment market must obtain an authorisation before they can do so; and obtaining that licence means being able to demonstrate that the product they are providing is fit for purpose.

Surely we can find a way to do something similar to help protect consumers from pension scams?

- This article from 2014 provides a useful overview of how the initiative was positioned
- This list shows the Master Trusts that operate
- This page provides detailed information about the authorisation process and the hurdles that applicants need to get over
- This page shows the ongoing involvement of the ICAEW

Similarly, there is much to be learned from the way Origo's Transfer Service operates, as explained earlier.

Therefore, perhaps several organisations similar to and including the ICAEW and Origo could be invited to set out how they could apply a similar approach to the Master Trust Assurance Framework and Origo's Transfer Service to help solve the pension scam problem?

There can be no doubt that pension scamming is a huge problem in the UK; and that serious solutions are required. We believe that the very high financial motives for scammers to persuade people to transfer assets into propositions that will lead to extensive consumer detriment will mean that the scammers will find a way to do so, *if they can*. The solution must therefore be to make it *very difficult* for scammers to operate. Our proposed solution makes scamming very unlikely, because only propositions that meet certain criteria will be available to be transferred into. By making it very difficult for scammers to succeed we will help to eradicate scammers and thereby scamming.

A product gateway would be a fair, efficient and effective solution that would make a quick and significant contribution to solving the pension scams problem.

Part 2: The Promotions Gateway

Preventing Pensions, Savings and Investment Scams using the Financial Promotions Regime

A robustly policed and enforced Financial Promotions Regime (FPR) would provide an efficient and effective gateway control to prevent scams. Action after the event is also needed to create a credible deterrent but by then consumer harm has been done; prevention is better than cure.

However, fundamental flaws with the current FPR and its enforcement have left the gateway open to scammers. These flaws are a major factor behind the current epidemic of scams targeting consumers' pension savings.

The current Financial Promotions Regime requires financial promotions issued by unauthorised firms must be approved by a Financial Conduct Authority authorised firm subject to a number of exemptions.

Regulatory Background

Financial promotions are restricted under Section 21 of the Financial Services and Markets Act 2000, pursuant to which a person must not, in the course of business, communicate an invitation or inducement to engage in investment activity unless the promotion has been made or approved by an authorised person or it is exempt. Unauthorised firms often use authorised firms which are authorised to carry on a regulated financial services activity to approve their Promotions in order to comply with the regulations.

Authorised firms are not required to notify the FCA once they have approved an unauthorised firm's Promotion, nor does the FCA sign off on approved Promotions before they are communicated to consumers. As such, the FCA is only made aware of potential breaches of the relevant regulations.

1. Issues with the existing Financial Promotions Regime

Regulation Issues:

i. There is no specific permission FCA authorised firms are required to have before they can approve a financial promotion.

ii. There are no qualification or competency requirements for firms approving financial promotions.

iii. There is no requirement to register or process for registering investments for which financial promotions have been approved. Hence neither the FCA nor consumers have access to records of investments where the promotions have been approved.

iv. Authorised firms and unauthorised firms with a FCA authorised group company are able to issue financial promotions without independent approval is a significant cause of consumer harm. Examples being London Capital & Finance and Basset & Gold

Transparency issues:

v. Consumers cannot establish whether a promotion genuinely has been approved.

vi. Consumers cannot establish whether approval of a financial promotion has since been withdrawn. This is a particular problem in practice with investment scams and frauds whereby a rogue FCA authorised firm approves a promotion then immediately withdraws approval.

vii. Consumers often believe that approval of an information memorandum for an investment by a FCA authorised firm means that the investment itself is regulated by the FCA. Sometimes the firm may be regulated but the product might not be; there have also been instances of products that have been regulated but the FCA has *ex post* claimed otherwise

viii. There is no reliable way for consumers to establish whether a firm offering its own securities is carrying out a regulated activity. Scammers thrive on this

viii. There is no reliable, independent or efficient means for publishers of adverts (including online platforms) which are financial promotions to verify whether a promotion has been genuinely approved by an FCA authorised firm.

ix. There is no reliable, independent or efficient means for pension trustees, ISA managers, banks, building societies to verify whether a product subject to a client transfer has been lawfully promoted.

Exemption Issues:

i. Online platforms operating from EEA states outside of the UK such as Google Ads and Facebook are currently exempt from UK regulations relating to financial promotions. As a result, the online advertising platforms are not liable for the content to the adverts they charge to publish and so take no responsibility or effective action to vet advertisers and adverts. This issue is evidenced by the following from a 31 Jan 2020 email from FCA Chief Executive Andrew Bailey to Mark Taber:

> *Our analysis is that search results generated by Google and, in particular, paid adverts may constitute financial promotions. Google is likely to be 'communicating' such financial promotions for the purposes of the restriction in section 21 of FSMA. Google is not authorised by the FCA. So any financial promotions communicated by Google must be approved for the purposes of section 21 unless one or more exemptions in the FPO applies to their communication. On the basis that it provides an information society service, for the purposes of the EU E-Commerce Directive, from an EEA state outside the UK, it appears to us that Google generally benefits from the exemption in Article 20B of the FPO for incoming electronic commerce communications.*

ii. Unauthorised firms are able to issue unapproved financial promotions to consumers classified as HNW / Sophisticated. This exemption is being abused beyond belief by unregulated introducers and the boiler rooms they work with. They hide it in the small print, make the sale verbally then get a signature at the last-minute glossing over it as an inconsequential bit of paperwork. Also, many vulnerable consumers also happen to qualify as HNW and are being targeted using 'sucker lists' or via fake comparison sites. For example, elderly with dementia / isolated, recently bereaved with inheritance, people with dyslexia, people disabled by accident with compensation.

Enforcement issues:

i. It is a criminal offence for an unauthorised person to issue a financial promotion which has not been approved under s21 of FSMA by an FCA authorised firm. However, the FCA's annual enforcement reports reveal that no financial promotions cases were opened or closed in 2017/18 and just 3 were opened with none closed in 2018/19. *Senior sources at the FCA are saying privately that there is a legal problem preventing them from prosecuting financial promotions offences*. This was reported by **The Times 19 September 2020:**

> ***Young people lose thousands in trading 'scam' promoted by Instagram influencers***
>
> *The Times understands that part of the reason for the inaction is a stand-off between the FCA and the Treasury.*
>
> *A source familiar with the situation said: "The FCA say privately they have a problem enforcing these laws but the Treasury say they have given the FCA strong powers to deal with this so we are at an impasse."*
>
> https://www.thetimes.co.uk/article/young-people-lose-thousands-in-social-media-trading-scam-tjw0xrldb

Hence there is no credible deterrent to prevent abuse.

ii. The FCA does not take enforcement action against firms which approve false or fraudulent financial promotions. The FCA's response to a recent Freedom of Information request from Mark Bishop stated:

> *We have not prosecuted any authorised firms or individuals connected to them for approving the communication of misleading or inaccurate financial promotions.*

The Times: 28 July 2020 - Financial Conduct Authority criticised for failure to act over misleading promotions

> *The Financial Conduct Authority did not prosecute any authorised firm or individual over errant financial promotions between 2013 and 2019 and fined only three groups of authorised firms and individuals, according to a freedom of information request.*
> *The regulator also said it did not remove any authorised firm's regulatory permissions for approving a misleading or inaccurate promotion.*
>
> https://www.thetimes.co.uk/article/financial-conduct-authority-criticised-for-failure-to-act-over-misleading-promotions-x8sfj5wbl

Hence the current Financial Promotions Regime is archaic, opaque, not fit for purpose and open to abuse in order to facilitate scams and fraud.

It is, in effect an invitation to scammers around the world to set up trade to prey on the UK's pensions, saving and investment market and it helps explain the pandemic-like proportions of our country's scamming problem

Why legislation must be improved and loopholes must be closed

A basic principle of law is that anyone who wants to take part in an activity that poses a high risk to the public should be regulated. If you want to own firearms for sport, drive a car, or offer investment securities to the public, you need to register yourself with the authorities. The law does not say you cannot do it, but if you are, you have a duty to show you are doing it responsibly.
But did you know there is a loophole in UK firearms legislation that allows you to own a high-powered assault rifle, as long as you put a sticker on it saying, "This Is Not an Assault Rifle"? And that even if you start walking around in public waving your not-an-assault-rifle in people's faces, the police will take no action until people start getting hurt?

No there isn't, *because that would be utterly ridiculous.* Yet this is the situation that UK legislation allows in the offering of unregulated investments to the public.

Unlike firearms, collapsed unregulated schemes do not kill people, but the impact on people's lives is often comparable to losing a limb, losing a loved one or suffering a chronic illness.

Legislation is progressively improved over time, usually after a disaster has made the failings of the existing legislation clear.

Any securities offering to the public should be registered with the FCA

UK financial services law is 86 years out of date and counting. In the United States, all investment offerings to the public are required to register with the Securities and Exchange Commission (SEC). The relevant US Securities Laws were enacted following the 1920s when companies often sold stocks and bonds on the basis of glittering promises of fantastic profits and without disclosing meaningful information to investors. Following the stock market crash of 1929, the U.S. Congress enacted the federal securities laws and created the SEC to administer them.

The Securities Act 1933[1] regulates offers and sales of securities in the United States and requires the company to file a registration statement containing information about itself, the securities it is offering, and the offering. While registration statements are selectively reviewed by SEC staff, the SEC does not evaluate the merits of securities offerings, or determine whether the securities offered are "good" investments or appropriate for a particular type of investor. A registration statement must be declared "effective" before it can be used to complete sales to investors.

[1] https://en.wikipedia.org/wiki/Securities_Act_of_1933

As part of their registration they must provide accurate information on the investment offering and their financial position, certified by independent auditors. They must then file updates on a regular basis, also audited.

This does not make it impossible to run an illegal investment – nothing will. It does however make it a lot more difficult, because a) there are far fewer loopholes in what can be promoted to the public, and b) the requirement to publish accurate and timely information is more difficult to get around.

The UK Government should immediately introduce legislation requiring any entity offering securities to the public, to:

1. Register their investment offering with the FCA.
2. As part of that registration, provide comprehensive information regarding their business plan, existing financials, and projected cashflow, audited by an independent accountant.
3. Provide full updated accounts to investors on a six-monthly basis. No company offering securities to the public should be allowed to use "small company" exemptions from publishing full accounts. Any failure to file accounts on time should trigger an immediate investigation.

The definition of a "security" should mirror that used in the US. Contrary to myth, the definition of what is and isn't a security is well-defined and has been since the "Howey Test" was established in law in 1946.

None of this is impossible, disproportionate or unaffordable - this is how it has worked in the US for decades.

Furthermore, the "restricted investor" definition (people who can have ultra-high-risk unregulated investments advertised to them if they promise not to invest more than 10% of their capital) should be abolished. It is completely unenforceable.

By making the register publicly available it could then become a 'white list' whereby any investment not on it would be unlawful. As such the list could be used by pension trustees, ISA managers, banks, building societies etc, to screen their clients' transfer requests.

Overall Conclusion

In this additional submission we have attempted to set out a range of pragmatic initiatives. Each initiative would make a positive difference and the combination of several if not all of them would change the scams landscape beyond recognition. Urgent action needs to be taken; each and every day that passes without adequate consumer protections being in place is leading to extreme consumer detriment.

End.

October 2020