

Capping early exit charges for members of occupational pension schemes

Ensuring a fair and consistent approach across all defined contribution pensions

Government response

November 2016

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1 Introduction

1.1 On 26 May the government published a consultation paper “Capping early exit charges for members of occupational pension schemes – ensuring a fair and consistent approach across all defined contribution pensions”. The consultation, which ran until 26th August 2016, sought stakeholders’ views on proposals to introduce a cap on early exit charges imposed on members of occupational pension schemes who choose to leave the scheme early in order to access their pensions flexibly. Specifically, the consultation sought input on:

- The principles for capping exit charges in occupational pension schemes
- Exclusions to the cap
- The level and application of the cap

1.2 The consultation was run in parallel with a Financial Conduct Authority (FCA) consultation on the cap for personal and stakeholder pension schemes: “Capping early exit charges” CP/16/15¹

1.3 The consultation paper was aimed at:

- Pensions industry bodies and professionals;
- Trustees or scheme managers
- Pension scheme members and beneficiaries
- Employers and representative organisations and
- Any other source.

1.4 The government received a total of 28 responses to the consultation from a variety of pension schemes and representative bodies. The government is grateful to all respondents.

1.5 This document forms the government response to the consultation on introducing a cap on early exit charges.

¹ <https://www.fca.org.uk/publication/consultation/cp16-15.pdf>

2 Government Response

- 2.1 The responses to the consultation raised a number of questions about the nature of a cap on early exit charges in occupational pension schemes. There were some concerns raised about the need for a cap to be imposed on the pensions industry via legislation and the potential impact on remaining members of schemes. However, there was also a very clear consensus that there should be a direct read across to the cap being implemented for personal and stakeholder pension schemes and the need for members of all pension schemes to be treated equitably. As such, the government intends to implement legislation that will allow a cap on early exit charges in occupational pension schemes for those members who wish to access the pension freedoms.
- 2.2 It is important to recognise that the regulatory powers that underpin the introduction of a cap on early exit charges are different for personal and stakeholder pensions and occupational pension schemes. The cap on personal and stakeholder pensions is a requirement of the Financial Services and Markets Act 2000, as amended by the Bank of England and Financial Services Act 2016. The FCA have stated their intention to bring the rules into force on 31 March 2017. However, the government is currently seeking to introduce legislation via the Pension Schemes Bill that will amend the Pensions Act 2014. The government intends to use this in conjunction with existing powers in the Pensions Act 2014 to introduce legislation to cap early exit charges in occupational pension schemes.
- 2.3 The government sets out below how it envisages a cap on early exit charges will work in occupational pension schemes based on the feedback provided to the consultation and the evidence previously gathered by The Pensions Regulator² and the FCA³. Further detail on the responses that were received can be found in Annex A.

² TPR: Survey of flexible pension access, September 2015
www.tpr.gov.uk/exit

³ FCA Pension freedoms data collection exercise: analysis and findings, September 2015

Definition & Scope

- 2.4 Respondents raised a number of questions about what constituted an early exit charge and whether certain charges - such as those incurred that are associated with certain decumulation products like drawdown or Uncrystallised Funds Pension Lump Sums (UFPLS) - were included. The government's aim is to ensure, as much as possible, that the early exit charge cap applies in the same way for members of occupational pension schemes as the one that is being implemented for personal and stakeholder pension schemes.
- 2.5 In this context “*early exit charges*” are taken to mean ***all charges imposed on members (who are eligible to access their pension savings flexibly) when seeking to access their pension early, which they would not face if they carried out the same transaction at their pension age⁴.***
- 2.6 Any charges associated with accessing a decumulation option *are not* included in the cap as they would be incurred whether the member was accessing the product at their pension age or earlier.
- 2.7 The consultation asked specifically whether aspects of the existing legal definition of an early exit charge that relates to personal and stakeholder pension schemes, as set out in Section 35 of the Bank of England and Financial Services Act 2016 would be suitable for occupational pension schemes. There was general agreement from the responses that consistency across both occupational and personal and stakeholder pension schemes was necessary. However, given the difference in underlying primary legislation for personal and stakeholder pension schemes and occupational pension schemes it is likely that the definition of early exit charges will look different, when drafted, to that in the Bank of England and Financial Services Act 2016. It is, however, intended that it will have the same impact.

⁴ In this context “pension age” refers to the age at which a scheme has agreed that a member can draw an unreduced pension - they will not be subject to an early exit charge

- 2.8 The government has been clear that the intention of introducing a cap on early exit charges is to remove a barrier to people accessing the pension freedoms. In doing so this protects the principle that all consumers who are eligible to access the freedoms should be able to do so. In this context the government is only concerned with capping early exit charges for those aged between 55 and their pension age.
- 2.9 As set out in the original consultation the government has given careful consideration to the implications for those aged under 55 who are able to access their pensions early due to exceptional circumstances, for example due to ill health. In these cases, the evidence gathered so far indicates that these people are unlikely to incur an early exit charge. In circumstances where people under the age of 55 who are looking to transfer their pension incur an early exit charge, they cannot, by definition, access the pension freedoms and are, therefore, outside the scope of this consultation.
- 2.10 In its consultation the government acknowledged that it is generally undesirable to interfere with existing contractual rights. This can only be justified where it is necessary to achieve important public policy goals and where the action is proportionate and in the public interest. The government believes that, with regard to early exit charges, the action is proportionate and in the public interest.

Exclusions to the cap

- 2.11 In its consultation, the government proposed to exclude Market Value Adjustments (MVAs) from the definition of early exit charges in personal and stakeholder pensions and set out its reasons for doing so. The government has introduced regulations aimed at excluding MVAs in personal and stakeholder pension schemes from the exit charges cap. Similar legislation will not be required for occupational pension schemes as MVAs are not covered by the definition of an “administration charge” in Schedule 18 of the Pensions Act 2014.

2.12 The consultation also considered terminal bonuses in the context of personal and stakeholder pension schemes and, specifically, that in situations where a scheme member might have a “reasonable expectation” that they were entitled to a terminal bonus, reducing or not applying the bonus did not constitute an MVA. Terminal bonuses will be out of scope of the cap for occupational pension schemes as they are not a charge and so not covered by the definition in Schedule 18 of the Pensions Act 2014. In circumstances where there is a guarantee or “reasonable expectation” of a terminal bonus being paid then it is the government’s view that this should be treated for these purposes as forming a part of the total value of the member’s pension pot.

2.13 Notwithstanding the position to exclude MVAs and terminal bonuses from the scope, any other “exit charges” derived from occupational pension scheme investments in “with-profits funds” will still be captured by requirements of the cap. Again, this is to ensure that no member of any occupational pension scheme is disadvantaged with regard to being able to access the pension freedoms.

Level of the cap

2.14 The government consultation sought to gather any evidence that suggested that occupational pension schemes should be treated differently to personal and stakeholder pension schemes in terms of the level of the cap. The overwhelming response was that there were no reasons why occupational pension schemes should be treated differently.

2.15 Therefore, in line with the proposals by the FCA in relation to personal and stakeholder pension schemes, the government intends to cap early exit charges for members of occupational pension schemes as follows:

- 1% for existing members of occupational pension schemes
- 0% for new members of occupational pension schemes

- 2.16 The government believes that using the date a member joins a scheme as the criteria for determining whether the 1% cap or the ban on early exit charges applies is the best way of aligning with the rules that are being put in place for personal and stakeholder pensions. As early exit charges in occupational pension schemes often derive from contracts entered into by trustees on behalf of members, reference to contracts is likely to confuse matters and create unnecessary complexity.
- 2.17 The intention is to have the appropriate regulations in force by October 2017. This will mean that from the date of commencement the cap will be implemented and there will be an effective ban on early exit charges for members that join an occupational pension scheme after this date.
- 2.18 The government considers that it would be most effective to place the primary duty to comply with the early exit charge cap on service providers and/or trustees or managers depending on who applies the charge in practice. The cap and ban will apply across all occupational pension schemes including any schemes currently imposing early exit charges on members wishing to access the pension freedoms.
- 2.19 In circumstances where an existing member of a scheme that applied an early exit charge decided to increase their contributions after the regulations come into effect, the government intends that the additional contributions would not be treated as new membership and would, therefore, be subject to the 1% cap. The government believes that making the distinction at member level will help to reduce complexity.
- 2.20 Schemes which currently impose early exit charges on members wishing to access the pension freedoms will have to offer different charging structures or terms to new members joining the scheme or accept that they will be unable to recoup any costs if these new members choose to access the pension freedoms.

2.21 The intention is that the 1% cap will apply to the value of the member's pension pot after any MVA has been applied

2.22 In circumstances where the existing contract between the trustees or managers of the scheme and the service provider, or the scheme rules explicitly specify that an early exit charge will be applied and this is below 1%, the government intends to legislate to ensure that the charge is cannot be increased.

2.23 Ultimately, it will be the role of the Pensions Regulator (TPR) to regulate compliance with the cap in line with its published "DC compliance and enforcement policy". This will include activities to support trustees and their advisers to comply with their legal obligations.

Communication

2.24 It is important that scheme members are made aware of the charges they are likely to face and what potential benefits they will be forgoing if they choose to access the pension freedoms. Clear communication between those imposing the charges and the scheme members is essential.

2.25 The law sets out circumstances where trustee boards must communicate with members. The government does not intend to add legal requirements to communicate the exit cap at the present time but will keep this under review. Where the law requires certain information to be provided, TPR also expects trustees to consider what additional information or explanations might be needed to help members.

Enforcement

2.26 The government's understanding (based on evidence provided in response to the consultation and collected by the FCA and TPR) is that in the majority of cases these charges are a legacy of charging structures that were predominantly used in the 1990's. They are applied by the service provider who administers the scheme on behalf of the trustees or managers. No evidence

has subsequently been provided to suggest that early exit charges could be applied by more than one party involved in the scheme. However, there is a small likelihood that occupational pension schemes exist where more than one party applies a charge. In these circumstances the government intends to legislate to ensure that the scheme member is not charged more than 1% of the value of the member's "pot".

2.27 As set out in the consultation, the government intends that TPR will be responsible for regulating the early exit charge cap for occupational pension schemes.

Impact of the cap on the length and type of investments

2.28 A number of responses to the consultation raised concerns about the potential impact that introducing a cap on early exit charges might have on the length and type of investment that pension schemes would choose to make in the future. The concerns centre around the impact on certain types of pension schemes, such as occupational pension scheme investment in "with-profits funds" and investment in infrastructure and property. If members are able to withdraw their pensions early from such schemes or investments with a capped charge for doing so, then respondents argue this is likely to encourage pension providers to move away from longer term investments in infrastructure and property. They would focus instead on shorter term, more liquid returns.

2.29 Whilst the intention of the cap is undoubtedly to remove barriers for people to access the pension freedoms and, as such, see an increase in the number of people who do access their pensions in this way, the government does not believe that there will be such a significant increase that it will destabilise the industry and fundamentally change the way pensions funds are invested. There are a number of reasons why this is the case:

- I. The evidence that has been collected on the prevalence of early exit charges in occupational pension schemes suggests that they occur in a

small number of cases. TPR's survey⁵ on exit charges suggested that around 3% members faced early exit charges.

- II. Only a minority of members currently facing early exit charges are expected to take up the pension freedoms. In the Impact Assessment⁶ published alongside the original consultation, the government set out its best estimate of the number of members who currently face an early exit charge that would choose to access the pension freedoms if exit charges were capped. There is a degree of uncertainty about the future behaviour of this group but as a proxy estimate the take-up rate of the pension freedoms amongst all those eligible for the freedoms was used, the majority of whom do not have early exit charges. This approach was approved by the Regulatory Policy Committee⁷.

2.30 Whilst the numbers of individuals who face an early exit charge when leaving their existing pension scheme to access the pension freedoms is low this is an important issue for those facing such charges. The government does not believe it is necessary to alter its proposed approach.

Next steps

2.31 The Pension Schemes Bill currently progressing through Parliament makes provision that will support the government's intention to introduce regulations capping or banning early exit charges in occupational pension schemes.

⁵ <http://www.thepensionsregulator.gov.uk/docs/survey-exit-charges-dc-2016.pdf>

⁶ For more detail on how this estimate is derived see the Impact Assessment available online at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525859/impact-assessment-cap-on-early-exit-charges-in-trust-based-occupational-pension-schemes.pdf and the additional analysis available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/526134/occ-pen-exit-charges-ad-hoc-analysis.pdf

⁷ The Committee rates the quality of evidence and analysis supporting new regulatory and deregulatory proposals. It checks the estimates for the equivalent annual net cost to business of new regulations.

2.32 The government intends to consult publicly on the draft Regulations in early 2017 with a view to making them in time for them to come into force in October 2017, subject to Parliamentary approval.

Annex A: Summary of Responses

Is there any reason why Government should not adopt this approach in relation to occupational pension schemes?

1. A number of respondents questioned how many occupational pension schemes are affected by exit charges and felt this was very low. Such arrangements have largely been phased out and such charges are usually applied to old insured schemes where the insurance company secured the business by paying fees to advisers and expected to recoup these over the length of the contracts. Exit penalties were there to protect the initial outlay if the member decided to transfer.
2. Whilst two respondents raised issues, on a matter of principle, to government intervention, ensuring fairness and parity between both occupational and personal and stakeholder pension schemes was welcomed by most respondents. A consistent approach would avoid regulatory arbitrage.
3. However, there were concerns that a capped exit fee could create unfairness between scheme members who leave the scheme early to access the pension freedoms and those who stay until their policy matures. For example, those who exit a scheme early could avoid paying the full administrative fees. As most pension schemes impose upfront fees at the beginning when the policy is taken out some respondents felt scheme members leaving a scheme early may avoid paying the full administrative fees while longer term policyholders would be expected to pay the full amount.
4. Some respondents felt that providers should not be prevented from applying reasonable charges to cover reasonable administrative exit costs.
5. More generally, the age at which individuals are able to access the pension freedoms (aged 55 and over) has caused some concern with three respondents

raising the issue of unfairness and whether the age limit constitutes age discrimination. However, the respondents have acknowledged that this issue was identified and addressed in the original consultation paper (section 2.8)⁸.

6. Some respondents had already introduced a voluntary cap on early exit charges in 2016 to avoid unnecessary confusion and complexity for their customers.

Government response

7. The government has been clear throughout the process that the driving factor behind introducing a cap on early exit fees is to remove a potential barrier to accessing the pension freedoms that currently exists for a small but significant number of scheme members. It is also the government's intention to ensure that members of personal or stakeholder and occupational pension schemes are treated equitably.

Do you have any concerns regarding the proposed scope of the early exit charge cap? If so, we would welcome evidence of the likely detriment that might occur?

8. A number of respondents predicted that an early exit charge, if capped, would simply be relabelled and recouped elsewhere. Two respondents suggested schemes would increase their "per transaction" costs to cover financial shortfalls.
9. There was a request for clearer wording to denote that normal administrative costs do not form part of an early exit charge (especially if the member is transferring to a more complex scheme like drawdown which requires more administration/costs).

⁸ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/526040/consultation-capping-early-exit-charges-for-members-of-occupational-pension-schemes.pdf

10. One respondent asked for clearer wording in relation to the distinction between existing and new contracts. If an existing account is closed to new contributions but the scheme member adds more contributions which are put in a different tranche does this constitute them being a new member (what level of cap would they be subjected to?).
11. Issues were raised around the scope of the cap and whether it will encourage “irresponsible” behaviour from scheme members. For example, whilst a cap would provide an attractive incentive for individuals to withdraw their pension pot early before their normal retirement date this could be to the detriment of the rewards which could be enjoyed if the scheme was left to mature (e.g. Guaranteed Annuity Rates).
12. One respondent raised concerns about With Profits funds (WPF) and implementation of the cap which will mean a reduction in the present value of the future income of WPF capital. The reduced surplus acquired previously from charges will lead to lower future bonus declarations.
13. Two respondents had concerns that retrospectively amending existing contracts will have significant consequences far beyond exit charges and pension contracts. This sets a dangerous precedent and could lead to higher charges in the longer term for members to cover the cost of the cap in early exit charges.

Government response

14. The government believes that any person wishing to access the pension freedoms should think carefully about the decisions they make, balancing potential future rewards against the benefits of accessing the pension pot early. Pension Wise is available to provide free and impartial guidance to help individuals make these important decisions.
15. The original consultation set out clearly why the government was taking action to cap early exit charges. It recognised that it was undesirable to interfere with

existing contractual rights unless there was justification on the grounds of achieving important public policy goals. In these circumstances the government believes that this action is proportionate and in the public interest.

16. As discussed earlier in the response the government intends that the cap will apply on a member basis. Therefore, in the scenario outlined in paragraph 10 the 1% cap would apply, additional contributions would not constitute being a “new” member.

Is there any reason why such a definition of early exit charges would not be suitable in relation to occupational pension schemes?

17. Whilst there was general agreement that consistency across occupational and personal and stakeholder pension schemes was necessary this question did raise some concerns about the proposed wording and terminology amongst respondents.
18. An issue was raised about some of the wording in paragraph 6(b) of section 137FBB in the Financial Services and Markets Act 2000 “*is only imposed, or only imposed to that extent*”. Was use of the word “only” an indicator that if the same exit charge is applied to members of a scheme both when transferring out before normal minimum pension age and taking benefits on or after their pension age, then it will not be capped? Was this the intention?
19. Concerns were raised about drawdown services offered by occupational pension schemes (including Master Trusts) and whether there are grounds where charges levied by the scheme may end up breaching the proposed definition contained in section 35 of the Bank of England and Financial Services Act 2016. Administration fees levied for the purpose of maintaining the cost-effectiveness of the drawdown arrangements should be outside the definition of the exit charge.

20. One respondent asked that “expected retirement age” needs to be better defined. For example, does it mean target retirement age, normal pension age or another definition.
21. One respondent felt the definition fails to allow for the cost of options chosen by the trustees. For example, a significant number of occupational pension schemes have the trustees choosing to receive an enhanced allocation to the incoming transfer value to nullify the impact of exit charges on the previous policy or scheme resulting in reduction of death benefits. They should be entitled to recoup these costs which could be substantial - up to 20% of the fund value.
22. One respondent asked where drawdown administration stands.

Government response

23. As set out in Chapter 2 “Scope and definition”, the government recognises that the definition in the Bank of England and Financial Services Act 2016 relates to personal and stakeholder pension schemes and a similar provision will be required for occupational pension schemes. Any charges associated with decumulation products are out of scope of the cap. The cap intends to capture charges that would not be incurred if the member accessed their pension at their pension age. In this context, “pension age” means the age at which a member would be able to access their pension without incurring any early exit charges.
24. It is worth reiterating that the purpose of the cap on early exit charges is to remove a potential barrier for people aged 55 and over to access the pension freedoms. With this in mind, schemes that have chosen to receive an enhanced allocation to the incoming transfer value in order to nullify the impact of exit charges are within scope of the cap and will need to ensure that they comply with the cap.

Do respondents have any views on this analysis or further information specifically:

- a) Do respondents have additional evidence on the prevalence of early exit charges in occupational pension schemes, including who imposes these charges?
- b) Are respondents aware of any other costs or charges that might constitute an exit charge specifically in an occupational pension scheme?
- c) Where respondents charge an early exit charge, are these charges applied in the same way for all scheme members or does the calculation vary for different cohorts of members within a particular scheme?
- d) Are respondents aware of any instances where the requirement to charge an exit charge is set out in the trust deed or rules rather than as a consequence of contractual arrangements?
- e) Evidence of the likely impact on scheme trustees or managers and third parties who administer occupational pension schemes of imposing the proposed cap?

25. As with responses to Question 1, the general consensus of opinion was that early exit charges will apply in very few cases. Where they are applied, their application will be based on individual circumstances and in accordance with the terms of the contract with their scheme provider.
26. One respondent felt the analysis and impact assessment methodology was flawed and significantly underestimates the costs to the industry. For example, the estimated rates of early exit for the lower levels of the cap are too low as, if the cap were set at the lower levels; it would become de-facto “best advice” for many customers to exit their pension scheme at 55.

27. One respondent raised the question of which factors determine the level of the cap where it is the trustees who decide any exit charges to be applied. For example, is it the date on which the trustees enter into a contract with a third party administrator so that any existing arrangements will be subject to the 1% cap but if the third party administrator changes in the future then the 0% cap applies? Would the member level apply and, if so, there needs to be clarity of exactly to which funds the level of cap applies - new schemes, new members of existing schemes who join the scheme after the date the regulations come into force, or to new contributions (after the date the regulations come into force) by existing members in existing schemes. They felt that treatment of individual and bulk transfers needs to be clear.
28. The consultation drew reaction to the many different charges that might be levied when a member leaves a scheme early. These included Capital Unit charges, Flat rate administration fee and loss or reduction of a loyalty or terminal bonus. One respondent raised the risk that administration charges for processing a transfer request could be used to effectively constitute an early exit penalty rather than reflect the administrative cost of processing the scheme member's exit. There are risks that administration fees could be raised to recover charges that would otherwise be lost through application of the cap.
29. One respondent raised the issue of scheme wind ups which no longer have a sponsoring employer. In some cases there will be a supplementary or reserve fund from which the cost of winding up the scheme can be met but, in many cases, no such fund will be available and the costs will need to be made up from members' funds. It would be inappropriate to include imposition of such costs and expenses in any definition of an exit charge.
30. One respondent felt that third party administrators should not be held legally responsible for imposition of the cap unless they have the power to determine how and when early exit charges are imposed. However, they will often be deducting the charge on behalf of another party and will be incurring significant costs in changing systems and process to accommodate the cap and may not be able to recover these implementation costs. In addition, the direct impact of

the proposed cap will also remove the ability of third party administrators to recover the costs of commission incurred when the individual joined the scheme which would otherwise be recouped via the exit fee.

Government response

31. As set out previously in this response, an early exit charge relates to any charge that a member has to pay for leaving their scheme before their pension age that they would not have to pay if they leave or take their pension at their pension age. As such, any administrative fee that is levied on a member if they leave early that would not have been levied had they left at their pension age is in effect an early exit charge and should be capped accordingly.
32. In the case of bulk transfers the date on which the trustees enter into a contract with a third party administrator will determine the level of the cap. For any existing arrangements into which the member is transferred prior to the coming into force of the regulations, this will be the 1% cap, but if the third party administrator is changed in the future or the members are transferred without consent after the coming into force date, then the 0% cap will apply.
33. As set out earlier, the government intends to impose the duty to comply with the cap on the party that applies the early exit charge. The evidence suggests that in the majority of cases this is the third party administrator or service provider. The government does not consider scheme wind ups to be early exit charges and, as such, the cap will not apply.
34. The government has considered the issue of estimated rates for the lower levels of the cap and whether these are too low. The estimated take-up of the pension freedoms amongst those facing early exit charges in the impact assessment was based on the take-up rate amongst all those eligible for the pension freedoms following the policy's introduction. Most members do not face early exit charges⁹ but it is estimated in the impact assessment¹⁰ that, despite

⁹ <http://www.thepensionsregulator.gov.uk/docs/survey-exit-charges-dc-2016.pdf>

¹⁰ For more detail on how this estimate is derived see the Impact Assessment available online at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525859/impact-

this, only a minority has used the pension freedoms. This suggests that the presence or level of an exit charge is not the sole factor in determining whether an individual takes up the pension freedoms. While there remains a degree of uncertainty in predicting the future take-up of the pension freedoms amongst those individuals who would have faced higher early exit charges in the absence of a cap, the government does not believe that there is sufficient evidence to suggest that introducing a 1% cap would lead all or most members to exit their scheme early.

Do you have any comments on the proposed definition of MVAs? Are there any other features of an MVA that would need to be captured in any definition?

35. This question attracted a range of comments and concerns. A number of respondents stated that providers already have obligations as specified in the FCA handbook. Five respondents felt it would be sufficient if the regulations exempted pay-outs from “with profits” policies. One respondent stated that there are other deductions permitted from a client’s “with profits” funds as specified in the FCA handbook. The government should follow the FCA’s policy on this.
36. One respondent wanted the definition of an MVA to include acknowledgement of MVA free dates (usually the retirement date of the scheme member) as the application of a contract guarantee. One respondent was in agreement with the definition provided that the government only makes policies in respect of the Financial Services and Marketing Act 2000.
37. One respondent stressed the importance of clear communication to members. A member may perceive an MVA to be a reduction in payment. Cash balance

[assessment-cap-on-early-exit-charges-in-trust-based-occupational-pension-schemes.pdf](#) and the additional analysis at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/526134/occ-pen-exit-charges-ad-hoc-analysis.pdf

schemes should be explicitly recognised so consumers view them separately to exit charges.

38. One respondent felt that if the government wanted pension schemes to invest in infrastructure and property they should not constrain the liquidity of the investments by applying the exit penalty to funds intended for this use. They argued that the MVA exclusion isn't suitable in that instance and there should be as few deterrents on infrastructure as possible.
39. Some respondents raised concerns about some of the phrasing of MVAs. One respondent felt reference to "indicative value" could cause confusion. The indicative value last communicated to the member could mean a non-guaranteed bonus that has since changed. Section 3.7 of the consultation document uses the phrase "generally accepted actuarial practice". One respondent felt this was vague and prescriptive. They suggested this would be more appropriate to list the Technical Memoranda actuaries apply when calculating MVAs. One respondent suggested the definition would be better aligned to actuarial practice if it referred to reductions that may be made to the nominal value of a member's pension benefits if they exit the scheme early to align them with the market value of their assets at that point.

Government response

40. The government has been clear that MVAs are out of scope of the early exit charges cap. They fall outside the definition of an administration charge for the purpose of an occupational pension scheme. The government agrees that it is important that members are clear about the differences between an MVA and an early exit charge. These comments have been considered as part of the process of drafting the definition of MVAs for the purposes of the FCA cap.

Do you have any comments on the proposed approach to "terminal bonuses" and their exclusion from the definition of MVAs?

41. The government's proposed approach to terminal bonuses received a mixed reaction from those who responded. In order to remove ambiguity around the status of terminal bonuses where an individual has an entitlement to those assets, it was proposed that the regulations would make clear that any adjustments made to the value of the benefits that the member is entitled to receive by way of a terminal bonus (whether as a result of an express entitlement or as a reasonable expectation arising under the scheme) will not come within the category of permitted adjustments (as MVAs).
42. Four respondents agreed that terminal bonuses should be excluded from the definition of an MVA.
43. Eight respondents disagreed and thought terminal bonuses should be granted at the provider's discretion. In this regard it is important to note that the Government agrees that decisions as to the size of those terminal bonuses which are paid at the discretion of the provider fall wholly outside the scope of the cap. The respondents argued that they should be grouped together with MVAs and excluded from the proposed early exit charges cap. For example, one respondent believed it was almost impossible to exclude terminal bonuses from defining an MVA because any MVA applied on the claim operates to reduce the terminal bonus paid on the claim. In deciding whether a bonus is a terminal bonus or whether it is an MVA could be used to circumvent the exit charges cap.
44. Three respondents agreed that terminal bonuses are different to MVAs but if the exemption uses the concept of pay-out (payments from with profits policies) it would not be necessary to have separate provisions for MVAs and terminal bonuses.
45. The consultation document highlighted cases where a scheme member is entitled to a terminal bonus – either as an express entitlement or as a reasonable expectation arising under the scheme (Para 3.9). Some respondents had concerns about the use of the phrase “reasonable

expectation” which they felt was very vague and what this constituted difficult to determine.

Government response

46. The government has considered these responses in respect of personal and stakeholder pensions, however, it continues to believe that where a member has an entitlement to the value of any benefits at the point of surrender, whether that entitlement arises in the ordinary operation of the scheme or as a consequence of the way in which a terminal bonus is determined, a reduction in those benefits for those leaving their pension scheme aged 55 and over but before their pension age should be considered an early exit charge. Conversely, determination of their sum payable by way of a terminal bonus that is paid at the discretion of the provider cannot properly be considered a charge and falls outside of any cap. These comments have been considered as part of the process of drafting the definition of MVAs for the purposes of the FCA cap.

Would a similar definition of MVAs assist trustees or managers to determine what was in scope of the exit charge?

47. From the responses received on this question there was agreement that a consistent approach would be helpful but there will be key differences between occupational and personal and stakeholder pension schemes. One respondent suggested the definition should be extended to redemptions from property funds to promote infrastructure investment. One respondent stated that MVAs only apply to with profits funds operated only by insurance companies and, therefore, the definition might not be of use to scheme trustees/managers.
48. One respondent questioned how narrowly or widely MVAs should be drawn. Pension funds are long-term investors and in certain asset classes can constrain the liquidity of the investments. If the government wishes pension schemes, and their members, to invest in property and infrastructure it seems

appropriate that such funds are not precluded from being used by pension schemes by being subject to the exit penalties. Is it appropriate to extend the MVA exclusion to such funds?

Government response

49. The government recognises the difference between personal and stakeholder pension schemes and occupational pension schemes and that there are differences in the way they operate. However, as set out previously, the government is clear that members of both personal and stakeholder pension schemes and occupational pension schemes should be treated equitably and not be hindered from accessing the pension freedoms by prohibitive early exit charges. As such, “with profits” schemes and other types of schemes that invest in property and infrastructure will still be subject to the cap and fall outside the definition of an MVA.

Is there any evidence to suggest that applying a cap calculated as a percentage of the size of the pension pot would unfairly disadvantage certain schemes?

50. There were a variety of responses to this question. A common theme which emerged from responses was the complexity of the issue - “there is no single, simple solution that deals equally effectively with all circumstances” or “one size fits all”.
51. Some respondents were in favour of the percentage calculation as most schemes currently use a percentage calculation already. However, some respondents felt the percentage calculation would be unfair as the charge should reflect the amount of work that went into administrative costs for the member’s early exit from the scheme. Issues around Self Invested Personal Pensions (SIPPs) and Small Self-Administered Schemes (SSAS) were also raised. These have much higher administrative costs if a percentage was used. Other concerns included: the temptation for providers to raise all charges to

1%; has there been an oversight with using a percentage cap for UFPLS?
Where a member takes 100% of the fund the scheme would charge 1% of the whole fund even though this would be higher than 1% of the payment which is being taken through an early exit from the scheme.

52. A suggested alternative was to have a compromise where the cap is set at 1% but with a maximum charge to reflect administration costs (possibly up to £500).
53. A number of respondents referred to the impact of Automatic Enrolment on pension pot sizes. Most Auto Enrolment pension pots are small and a percentage charge would not meet administrative costs.

Government response

54. As stated previously, the proposed cap will not apply to any charges associated with decumulation products. References to administration costs for processing the early exit are also potentially misleading, as they will fall outside the scope of the cap only if they also apply to members who access their pension at their pension age. With regards to fixed cost charges, there is nothing to prevent service providers charging a fixed amount to cover certain costs provided that;
- i. the charge falls outside the scope of an early exit charge e.g. it is an administration charge that would be applied when a member left the scheme at their pension age, or
 - ii. the charge did not exceed 1% of the value of the members pension pot, and
 - iii. is not increased in the future.

Is there any evidence to suggest that occupational pension schemes should apply a different level of cap to that applied to personal pension schemes?

55. No evidence was provided to suggest there should be a different level of cap for occupational and personal and stakeholder pension schemes. Consistency in approach would reduce regulatory arbitrage.
56. One respondent did raise concerns about consistency of terminology between occupational and personal and stakeholder pension schemes which could be difficult in aligning a cap for both types of scheme. For example, who is new versus existing, where do new contributions made after the regulations come into force stand, where do bulk transfers/third party administrators stand.

Government response

57. As outlined earlier in the response, the government intends to introduce the same level of cap for occupational pension schemes as that which will be put in place for personal and stakeholder pension schemes. The issues raised in paragraph 56 have been covered in Chapter 2 of this response.

Do you agree with the levels of proposed cap?

58. There was support for the levels of cap proposed in the consultation document - 1% for existing occupational pension scheme contracts and 0% for new occupational pension scheme contracts.
59. However, some respondents questioned the need for a cap. For example, one respondent felt exit charges were reasonable taking into account the whole charging structure and other benefits. One respondent questioned why the government and the FCA did not consider and assess the possibility of a flat rate cap, perhaps graduated by fund value, alongside the proposed cap based on a percentage of the fund value.
60. One respondent had concerns about application of the cap and ensuring it was kept to a maximum of 1% for scheme members leaving a scheme early to access the pension freedoms. For example, there could be a charge for exiting

the scheme early and an administrative charge which could total 1.5%. How would these be capped at 1%? How would VAT be applied to the cap - on top or included.

61. Concerns were also raised about inconsistencies with other recent legislation. For example, why were exit fees from ISAs approved at 5% in the last Budget and how the proposed cap will sit within the 0.75 cap on default arrangements?
62. One respondent had concerns about a service provider being able to increase charges in particular circumstances. Schemes already charging less than 1% on exit will not be permitted to increase their charge, even within the cap. However, in the case of bulk transfers exit charges may be temporarily waived after a member has transferred into the scheme. The scheme should be permitted to increase the charge back to the normal level, or to the level of the cap if lower, at the end of the specified period.

Government response

63. The government has already outlined its reasons for introducing a cap in this consultation and others before it. There is some read across between the early exit charge cap and the default 0.75% cap on auto enrolment charges. The 0.75% cap applies to member borne deductions paid to the pension provider or another third party (excluding transaction costs). The early exit charge applies to charges that are levied on the member if they choose to leave the scheme in order to access the pension freedoms. In circumstances where both caps apply, the level of cap when a person leaves the scheme early to access the pension freedoms will depend on the makeup of the charge with the 0.75% cap on auto enrolment charges taking precedent.
64. Exit fees on pension products are fundamentally different to the charge applied if someone takes their money out of their Lifetime ISA outside the permitted circumstances. Where people have early exit charges on existing products, they will have signed up to these before the pension freedoms came in to force and so could not have made an informed decision in light of the pension

freedoms. The Lifetime ISA is a different product and it is clear from the outset when the charge will apply.

What is the risk that other charges or fees will be used to recoup costs?

65. There was general consensus that reputational constraints and/or industry competition, which should be encouraged by government, will prevent early exit charges being concealed in other charges. In the case of occupational pension schemes the presence of scheme trustees/managers and their requirement to agree changes to fees and charges would also be a deterrent.
66. However, one respondent had concerns that the introduction of a cap would inevitably necessitate insurance companies revising how they cover their costs, possibly through subsidies from other policies or parts of the business. This could be deducted from returns to shareholders, re-investment in the business or lowering service levels in relation to other areas with service providers determining how to manage this.
67. If providers were so inclined to recoup costs, this would most likely be concealed in Annual Management charges.
68. One respondent had concerns that scheme members under the age of 55 are likely to bear the brunt of higher charges to recoup costs which could constitute age discrimination.

Government response

69. Ultimately, it will be the role of TPR to regulate compliance with the cap in line with its published “DC compliance and enforcement policy”. This will include activities to support trustees and their advisers to comply with their legal obligations.

What actions should the Government consider to mitigate this?

70. The role of government in mitigating against the use of other charges to recoup costs was questioned by a number of respondents. The government imposing a cap on auto-enrolment charges which limited the scope for raising charges was highlighted by some respondents.
71. One respondent pointed out that trustees or managers should be familiar with, and understand, the impact of the terms and conditions of contracts with service providers and the priority is for trustees to have well informed views of the overall burden of costs and charges and a clear policy on how they should be met. Also, the market will dictate charging structures.
72. One respondent suggested a more rigorous statutory disclosure regime would improve the transparency standards for investors.

Government response

73. The government believes that the fiduciary duties that are currently placed on trustees and managers of occupational pension schemes and the impact of market forces and the need to compete for business within the pensions sector will deter providers from transferring revenue forgone to other charges. However, if evidence materialises to suggest that charges are being moved elsewhere, the government will explore legislative options to curb this.

Do you have any comments on the Government’s proposed approach to compliance and enforcement of the cap, including the intention to place duties on “service providers”?

74. Some respondents agreed with the suggested approach. However, some respondents felt that the obligation of enforcement should lie with whichever party has imposed the exit charge and not the service provider. There were

concerns about the duties being imposed on service providers who will often not be the party that determines whether such a charge should apply. They are merely acting as a collecting agent in order to fulfil their contractual duty to another party, such as the trustees or an insurer.

75. One respondent suggested that legislation should be overriding so that scheme rules, insurance policy terms and conditions and other contractual arrangements do not have to be re-written. This would significantly increase both the implementation timescale and the costs of applying the cap.

Government response

76. The majority of the evidence gathered during the course of this consultation suggests that it is service providers that implement these early exit charges where they apply. As such, the government intends to place the duty of complying with the cap on whoever it is that actually applies the charge in practice. In most cases this will be the service provider. In circumstances where more than one party applies a charge, the government will legislate to ensure that the scheme member is not charged more than 1%. The intention is that the duty will fall on the trustees or managers of the scheme to ensure that this is the case in such a scenario.

Are there any reasons why these arrangements would not be appropriate?

77. From the responses received to this question reasons offered up included an unrealistic timeframe for implementation given that changes to operating systems will be required to implement the cap and can be highly complex and time consuming. Insurance companies are also required to implement significant changes to life policy taxation and to European PRIIPS11 requirements along the same timeframe. Would a staged approach be more appropriate?

¹¹ Packaged Retail and Insurance based Investment products

Government response

78. As set out in the next steps section of Chapter 2, the government intends to introduce Regulations that will cap or ban early exit charges in occupational pension schemes. It expects these to come into force in October 2017 and should give service providers and trustees/managers sufficient time to implement any changes that are needed in order to comply with the cap.

Annex B: List of Respondents

ABI
Aegon
Association of School and College leavers
Association of Pension Lawyers
Association of Professional Pension Trustees
Aquilaheywood
Aviva
Baker and McKenzie
CAPITA
Financial Services Consumer Panel
Institute and Faculty of Actuaries
Investment and Life Assurance Group
Legal and General
Mercer
Pensions and Lifetime Savings Association
Pensions Ombudsman Service
Prudential
Royal London
Standard Life
Sun Life Financial of Canada
The Association of Accounting Technicians
The Law Society of Scotland
The Pensions management Institute
The Society Of Pension Professionals
TISA
TPAS
Willis Towers Watson
Zurich