HM Treasury

Pension transfers and early exit charges:

consultation

July 2015

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1 Introduction

The purpose of this consultation

1.1 In April 2015, the government introduced the most fundamental change to how people could access their pension savings in nearly a century. In removing the effective requirement to buy an annuity, the government has given savers the freedom to make their own choices about how they use their retirement savings in later life.

1.2 To ensure that everyone in a defined contribution scheme could access their pension savings flexibly even if their scheme did not offer flexible access, alongside this reform the government also strengthened people's right to transfer their pension to a provider or scheme that does.

1.3 The government wants to ensure that people can access the new pension flexibilities easily, and at reasonable cost. This consultation is seeking responses on options to address possible barriers to people switching their pensions to access the new freedoms including, excessive early exit penalties, the process for transferring pensions from one scheme to another, and the circumstances in which someone should seek financial advice.

1.4 The consultation will run for 12 weeks and a response will be published in the autumn. Alongside the consultation the Financial Conduct Authority (FCA) and the Pensions Regulator (TPR) are also carrying out a comprehensive evidence gathering exercise.

The new pension freedoms

1.5 As of April 2015, everyone aged 55 or over with defined contribution pension savings is entitled to access their pension flexibly, regardless of their total pension savings. Before the introduction of these historic reforms, the vast majority of individuals would have been subject to a 55% tax charge for withdrawing their pension fully. Individuals are now able to access their defined contribution pension savings as they wish, subject to their marginal rate of income tax.

1.6 The consultation *Freedom and Choice in Pensions* explored how best these reforms could be implemented. The government consulted extensively with a wide range of stakeholders, including pension providers, employers, consumer groups, think tanks, public sector bodies, law firms, actuarial firms and individuals. The responses to the government's proposals were overwhelmingly positive. There was a broad consensus that individuals who have been responsible, and saved for their future, should be given the freedom to access their pension savings in a way that most suits them.

1.7 *Freedom and Choice in Pensions* considered whether pension schemes should be required by law to offer flexible access to their members. The government concluded that this would be disproportionate in the light of the burdens it would place on some schemes. However, the government was keen to ensure that everyone in a defined contribution scheme could access their pension savings flexibly even if their scheme did not offer flexible access. To ensure this was possible the government strengthened people's statutory right to transfer for members of defined contribution schemes, and applied the right to transfer to other benefit categories.

1.8 The government welcomes the considerable progress the pensions industry has made in changing their systems and designing new products to give their customers access to new flexible options. The government has recognised that this will be a period of transition and schemes and providers will need time to adapt their systems and processes to the new

landscape. In addition, the government recognises that some schemes will not wish or be able to offer flexible options themselves. That is why individuals' right to transfer to a scheme which offers flexible options is so important.

1.9 As individuals have sought to engage with the new freedoms the government has become increasingly aware of potential barriers that they may face. In order to ensure that the market is able to operate as efficiently as possible, and that there are no barriers effectively prohibiting people from exercising their right to transfer, the government is keen to gather more evidence and, where appropriate, explore ways to strengthen people's rights to access their pensions flexibly, and remove any unjustifiable barriers to their doing so.

Potential barriers

1.10 This consultation:

- considers the issues around early exit charges, to ensure that people are not facing unjustifiable charges when moving scheme or accessing their pension savings flexibly within their scheme as part of the new freedoms;
- seeks views on how the process for transferring pensions from one scheme to another could be made quicker and smoother; and
- explores issues and concerns in relation to the provision and need for financial advice when making certain transfers.

1.11 The government is clear that if there is evidence of excessive early exit charges restricting individuals' ability to access the new freedoms, it will consider the option of imposing a cap on such charges for those aged 55 and over who are eligible to access the new freedoms.

1.12 Alongside this consultation the FCA and TPR are carrying out a comprehensive evidence gathering exercise, including on the existing processes for pension transfers and any fees and charges that members might incur for leaving their scheme early. The government has included a number of questions in this consultation which overlap with those asked by the regulators in the course of their evidence gathering exercise. This is because the government is keen to understand views on these questions from a wider group of stakeholders, including consumer representatives. Providers and schemes may wish to repeat the answer they have provided to the regulators, or refer to their answer to the regulators.

1.13 In deciding the scope of this consultation, the government has been guided by the principle that if an individual wishes to access to their pension under the new freedoms, they should be able to do so quickly and smoothly. As such, it is aimed at individuals carrying out transfers of flexible benefits, those with flexible benefits, and those moving from schemes with safeguarded benefits. This consultation only focuses on issues relating to pension transfers where the pension flexibilities apply.

Wider work

1.14 This consultation is another step in the government's wider reforms to encourage people to save for their later life and provide security in retirement, including the introduction of Automatic Enrolment, the new State Pension, and the ongoing consultation *Strengthening the Incentive to Save* on how the system of pensions tax relief might be reformed to support retirement savings.

1.15 Given the scale and nature of these reforms the government recognises that it is important to assess how they are being implemented in practice, of which this consultation and the

associated data collection exercise is a part. The government anticipates that this wider work will commence in the autumn and both FCA and TPR have recently set out their plans on their respective websites. In advance of this and to inform the on-going assessment of the implementation of the freedoms, the government recognises that there may be wider experiences industry or consumers may wish to highlight. Therefore the government would welcome submissions on any wider issues and challenges that you may be aware of regarding the new pension freedoms as part of this consultation.

Structure of this document

1.16 A brief summary of the issues covered by each chapter and annex is provided below.

- Chapter 2 explores issues and options in relation to early exit charges, including, if there is evidence of excessive early exit charges, the option of imposing a legislative cap on such charges for those aged 55 and over.
- Chapter 3 asks how the process for pension transfers from one scheme to another can be made smoother and more efficient.
- Chapter 4 considers issues and concerns in relation to the provision and need for financial advice to make certain transfers.
- Chapter 5 sets out next steps.
- Annex A provides a summary of the questions in this consultation.
- Annex B sets out the transfer process in legislation.

1.17 This consultation document invites interested parties to comment, over a 12-week period, and closes on 21 October 2015.

1.18 The government welcomes views on 14 questions, set out at Annex A, which cover, issues and options in relation to any excessive early exit charges, the process for transferring pensions from one scheme to another, and the requirement to seek financial advice.

2 Early exit charges

2.1 One of the key principles of the new pension freedoms is that individuals should be able to access their pension savings in order to use them in a way that suits their needs. This includes customers being treated fairly by their providers and allowed to access their savings free of disproportionate penalty charges.

2.2 The government is aware that the majority of individuals accessing their benefits are able to do so without disproportionate charges being applied. However, the government would like to understand whether some customers may still be unable to access the freedoms without being subject to disproportionate or excessive early exit charges.

2.3 This chapter:

- considers the definition of exit charges;
- asks for views on the prevalence of such fees;
- considers what is meant by unfair or excessive (and for completeness other investment deductions); and
- finally looks at options to reduce exit charges (should there be a case for intervention).

Defining exit charges

2.4 Exit charges are those fees and charges incurred when a customer transfers out of their pension into another fund or scheme, or otherwise accesses their pension flexibly before a date specified in the personal pension contract or, in the case of an occupational scheme, the scheme rules. Such charges generally only apply on early exits and so these individuals will still be able to access the new flexibilities without paying an exit charge by waiting until their agreed retirement date. On this basis, to be caught by an early exit charge, an individual needs to meet three conditions:

- they wish to transfer out of, or otherwise access, their pension;
- they wish to do this before their scheme's agreed retirement date; and
- their scheme applies a penalty for early exits.

2.5 There is no single working definition, either in legislation, or used by the regulators, to cover the various fees and charges that are commonly perceived as 'exit penalties'. In part, this is because early exit fees and charges can arise from a number of things, including: administrative costs to the provider; other charges related to the divestment of certain assets; and the recovery from members of an initial commission payment previously paid to an adviser.

2.6 Market value adjustments (MVAs) and the reduction or removal of a terminal bonus may also be interpreted as a 'penalty' for exiting a scheme early, however, as set out in the section on investment deductions below, MVAs allow providers to recoup costs when an individual leaves the scheme early as this can disrupt providers long-term pricing models. Similarly, a terminal bonus is paid at the discretion of the provider and is not usually guaranteed. As such, the government does not propose to consider in detail the position with regard to MVAs or terminal bonuses as part of this consultation.

Box 2.A: Types of pension schemes and safeguarded and flexible benefits

Pension schemes are classified broadly into two types

- those which have their legal origin in a contract, run by persons authorised to provide pension services ('providers'), known as '**personal pension schemes**'; and
- those which are based on a trust deed and rules - '**occupational pension schemes**' - which are usually set up by a single employer or a group of employers.

A single individual may enter into a contract to be provided with a personal pension. Many providers run group personal pension schemes for one or more employers and there are also schemes established by providers for non-associated employers and run under the umbrella of a trust ('a master trust'). Some occupational schemes choose to invest members' contributions in annuity contracts or insurance policies, held by the trustees for the benefit of members.

Pensions legislation and tax legislation classify pension benefits differently. At present (subject to the commencement of Part 1 of the Pension Schemes Act 2015), pensions legislation recognises two basic categories:

- **money purchase benefits** (defined in section 181 of the Pension Schemes Act 1993 ('the 1993 Act'); and
- the default category of **non-money purchase benefits**.

'Cash balance benefits' (i.e. benefits which provide a fund rather than a rate of pension, but which are subject to some kind of guarantee in the accrual phase) are classified as non-money purchase under the 1993 Act, but a money purchase arrangement under section 152 of the Finance Act 2004 ('the 2004 Act') includes cash balance benefits.

The Taxation of Pensions Act 2014 extended the rights of pension scheme members to use their benefits as best suits their needs. These flexibilities covered those with benefits classified as money purchase arrangements under the 2004 Act. The 1993 Act provides statutory rights for members to transfer their pension benefits. The Pension Schemes Act 2015 significantly extended the statutory rights to transfer for members of pension schemes covered by the flexibilities introduced by the Taxation of Pensions Act 2014.

In order to deal with the dichotomy between tax and pensions legislation, the Pension Schemes Act 2015 introduced the concept of **'flexible benefits'** , which is intended to cover cash balance benefits and money purchase benefits; i.e. those benefits which are classified, respectively, as non-money purchase and money purchase under the 1993 Act, but as money purchase under the 2004 Act.

The concept of **'safeguarded benefits'** also appears in the 2015 Act. This group of benefits excludes money purchase benefits and cash balance benefits but includes all other types of benefit with an element of guarantee. Most 'safeguarded benefits' include a valuable guarantee, and in order to ensure that members understand what they are giving up, they are required (by section 48 of the Pension Schemes Act 2015) to obtain independent financial advice before such a transfer can be concluded.

2.7 The government is clear that any option which could cut across existing contractual property rights, such as a statutory cap on exit fees, would represent a significant step. Any such measure should only be taken as a proportionate means of achieving a legitimate objective in accordance with the public interest.

The prevalence of exit charges

2.8 There is limited consistent research across the market regarding the prevalence of exit fees, which in many cases relate to policies dating back 20 to 30 years or more. However, information collected by the Department for Work and Pensions[1] suggests that as many as 1 in 10 savers in workplace schemes could be affected by charges when transferring their pension. Although many of these individuals will face charges that represent fair and reasonable charges to cover costs, the government believes there is a high degree of overlap between transfer fees and exit charges and in the case of the latter would like to understand, in particular, whether and why some charges may be significantly higher than others.

2.9 There is also evidence that there is a particular issue regarding certain pension products sold in the 1980s and 1990s. In some cases policy holders are reported to have been paying high annual management charges, with high exit penalties for switching to another provider. Although the majority of these schemes are now closed to new members, a significant number of these plans continue to operate for existing customers.

2.10 Separately, an independent review into legacy workplace schemes published in December 2014[2] found that roughly 7% (£4.8 billion) of assets under management in legacy schemes were in schemes where savers would face charges for early exit. Of this, £3.4bn (nearly 60% of funds) is in schemes with exit charges of 10% or more. The evidence described above provides relatively good coverage of the workplace market. However, the government is keen to obtain further evidence.

2.11 The FCA and TPR are carrying out a comprehensive data gathering exercise to better understand the scale and quantum of fees and charges that members might incur for leaving their scheme early. However, in addition to that exercise, the government would be keen to hear from firms and individuals where there are circumstances where individuals may have lost out as a result of not being able to access the flexibilities as a result of high exit charges.

2.12 The government is also aware that individuals may be exposed to other "exit" fees on accessing their pensions, for example where scheme trustees and mangers are charging fees even at an individual's selected pension age, or where certain bonuses or benefits may be removed for exits at a time different from when the arrangement had specified, and would welcome views on the prevalence of such practices.

Question 1: Do you have any evidence as to the scale and quantum of fees and charges that members might incur for leaving their scheme or accessing their benefits early?

Question 2: Are you aware of any evidence of charges that are levied at, or above, an individual's selected pension age? Are there any examples of customer detriment as a result of late exit penalties, and charges at an individual's selected pension age?

Unfair or excessive exit charges

2.13 The government considers that is important that individuals are able to access their money in order to use it in a way that suits their needs. Where an individual wishes to access their pension under the new freedoms, they should be able to do so quickly and smoothly and the government is concerned that exit charges may represent an unreasonable barrier to their doing so. For example, an exit charge might prevent an individual from accessing freedoms where the level of the charge represents a significant proportion of the funds being accessed, or where it is so high that even those with larger pots regard the level of the charge as prohibitive. In these

[1] DWP Landscape and charges survey 2013: charges and quality in defined contribution pension schemes.

[2] Available at https://www.fca.org.uk/static/documents/defined-contribution-workplace-pensions-ipb.pdf

circumstances, the level of the charge might be considered disproportionate and therefore unfair and excessive.

2.14 In order to assess the extent to which some exit charges represent a significant barrier to customers accessing the freedoms, and are indeed disproportionate, the FCA and TPR have asked firms to supply information on exit charges as part of their evidence gathering exercises. The government will analyse the position fully in light of evidence obtained by the FCA and TPR and alongside the responses to this consultation. The government would also be keen to hear from those who are able to provide information about the application of exit charges across the marketplace.

2.15 The government appreciates that it will not always be possible for those leaving their schemes or accessing their benefits earlier than their selected retirement date to enjoy all the benefits they would have had they stayed in their pension arrangement until maturity. This feature is common to many financial products, such as fixed-term bonds, and can reflect genuine commercial concerns on the part of the provider. However, there may be some circumstances in which the structure of an exit fee results in a charge at a higher level than the costs that a scheme or a provider has, or can reasonably expect to have incurred.

2.16 The government is keen to ascertain whether such fees could be considered either excessive or disproportionate, relative to the underlying cost of making a transfer or allowing the member to access their benefits early. Establishing whether some high exit charges represent a significant barrier to customers accessing the freedoms may also help to inform the government's view of what constitutes 'excessive' or 'disproportionate' charges.

Question 3: In your view, what would constitute an 'excessive' or unfair early exit charge? Please include any fees and charges that you would consider to be outside this definition and why.

Question 4: Are you aware of any evidence of exit charges impacting on individuals' decisions to access the flexibilities? Are there any examples of individuals losing out as a result of not being able to access the flexibilities in these circumstances?

Investment deductions

2.17 Alongside the broad umbrella of 'administrative costs' (covering the establishment, management and commission associated with the fund/contract), the government is mindful that in some situations, exit charges may be conflated with deductions to projected investment value.

2.18 Market value adjustments (MVAs), sometimes referred to as market value reductions, take the form of an adjustment to the underlying value of a person's rights in a with-profit fund contract when that individual leaves the scheme before their selected retirement date. These deductions are generally found in 'with profits' or with profits-like products, which are offered by insurers directly to members via personal pension schemes, or indirectly via trustees of occupational pension schemes.

2.19 Providers' rationale for applying MVAs in the case of personal pension schemes is to ensure that remaining investors in a scheme are not disadvantaged by the exiting member where investments are pooled – which could be the case if the surrender value (the amount payable to the individuals exiting the scheme) is higher than the current market value of the policy's assets. There is also an argument that, since customers are signing up to a long-term contract, early exits can disrupt insurers' long-term pricing models, built to incorporate long-term factors such as changes in interest rates. It is worth noting that MVAs generally appear to reduce as a saver approaches their selected retirement date.

2.20 Companies use different criteria on how they apply MVAs, including at what time they are applied. Some may apply an MVA on all investments that have been running for less than five years, or where the amount paid out to an individual saver exceeds a particular amount, e.g. £25,000. The government understands that MVAs are currently used by personal pension providers, and that they are not generally applied by occupational pension schemes.

2.21 The government does not propose to consider the position with regard to MVAs as part of this consultation. However, should evidence emerge that MVAs are being applied by occupational pension schemes in addition to, or instead of, using the process for calculating the cash equivalent[3] of the benefits, the government may wish to investigate this specific issue further.

2.22 A related issue is that of the terminal bonus – an additional bonus added to a with-profits policy, which is specified at the end of the contract. The terminal bonus is paid as a percentage of the final pay out at the discretion of the provider, and is not guaranteed. The terminal bonus can vary from year to year, by provider, and based on the performance of the underlying investments around the end of the policy. For this reason, those policy holders that leave their policy early may not be entitled to receive a bonus, or receive a reduced bonus, despite its existence potentially forming an attractive reason for joining the scheme in the first place.

2.23 While the reasons for these adjustments may be reasonable, there may also be a need for providers to improve their communication of these deductions to their members. A number of studies show that UK consumers have a limited understanding when it comes to more complex finance terminology. As such, while the government is not minded to include market value adjustments and terminal bonuses in the definition of exit fees, there may be an opportunity for providers to take additional steps to make the valuation that they send out to their members simpler and more transparent and, in the case of pension transfers, to explain in greater detail why particular fees and charges have been incurred.

Question 5: How could the simplicity and transparency of market value adjustments and other investment deductions (as opposed to exit charges) be improved to increase customer understanding of such fees?

Options to address excessive early exit fees and charges

2.24 If there is clear evidence of excessive early exit fees and charges and a sound rationale for policy action, the government has identified the following three options as a basis for further work to address the issue of early exit charges and would welcome views on them: a cap on all excessive early exit fees; a flexible cap in certain circumstances; and a voluntary approach to restricting exit fees and charges. Subject to the outcomes of this consultation, the government will consult on the legislative approach in a further consultation exercise. At present, the government would also be interested in alternative policy approaches to address the issue of excessive exit fees.

A cap on all early exit fees

2.25 The government could enact legislation aimed at capping all exit charges (excluding MVAs, and other investment deductions) for those aged 55 and over and before their scheme retirement date, either at a fixed percentage of the value of funds being transferred, or at a capped monetary amount. This would ensure that:

[3] A cash equivalent transfer value (CETV) represents the expected cost of providing the member's benefits within the scheme. In the case of money purchase benefits, this is generally straightforward – it is the accumulated contributions made by and on behalf of the member together with investment returns. In the case of defined benefits, the CETV is a value determined on actuarial principles, which requires assumptions to be made about the future course of events affecting the scheme and the member's benefits.

- for individuals there is a clear simple limit on the amount that they can expect to pay on transferring their pension or accessing their benefits flexibly within the scheme; and
- for schemes there is a clear limit on excessive charges.

2.26 However, the government is aware that there are a number of issues that would need to be worked through, for example, in instances where high fees may be attached to very small funds. The government is also mindful of any cap that could discourage investment in certain asset classes; and the potential legal impact on existing contracts of applying such a limit retrospectively.

A flexible cap in certain circumstances

2.27 As an alternative, the government would also welcome views on a more flexible approach to capping early exit charges. For example, in order to address concerns about smaller funds a cap could be limited to pots above a certain de minimis threshold; or could be tailored to apply to particular components of an exit charge that are difficult to justify as fair treatment of customers. The use of proportionate regulation targeted at certain charges has been a success in other areas, most recently in relation to pay day lending charges.

2.28 Although this option could be subject to some of the same challenges as Option 1, a more nuanced approach could allow for more egregious early exit charges to be capped to benefit customers, whilst ensuring that firms aren't unfairly penalised for charges which are justifiable.

A voluntary approach to restricting early exit fees and charges.

2.29 The government recognises the progress the industry has already made in introducing the new flexibilities, and would therefore welcome views on options that would allow the industry to take the leading role in addressing any concerns about early exit fees and charges. A voluntary approach would provide scope for trustees and managers to consider action, such as waiving or reducing early exit charges where members move from an existing arrangement to another offering flexibility, including within the same company or scheme. Such a voluntary approach would also be in line with the existing approach of enabling contractual provisions to be overridden in certain circumstances, where they would prevent providers from offering the new flexibilities.

2.30 The government would also be interested in suggestions for alternative policy approaches to address this issue.

Question 6: The government would welcome views on the pros and cons of each of the 3 approaches above. In particular, the government would be interested in views on particular components of an exit fee or other charges that should be considered to be in scope of any limit, and evidence on what might be the right level for any cap.

3 Pensions transfers

3.1 The principle that individuals should be trusted to use their own money in a way that best suits their needs is at the heart of the government's pension reforms. One of the key questions in the *Freedom and Choice* consultation concerned whether all defined contribution schemes should be required by law to offer flexible access to their members. It was felt that this would place disproportionate cost and administrative burdens on some schemes, especially small schemes and those with large legacy arrangements.

3.2 To ensure people would be able to access their savings flexibly even where their scheme chose not to offer flexible options, the government extended the right to transfer to a new scheme for those with flexible benefits and also applied the right to transfer for those with flexible and safeguarded benefits. Previously, individuals only had the right to transfer up to one year before their scheme's normal retirement age. To maximise flexibility, the government amended pension legislation to give individuals with flexible benefits a statutory right to transfer up to and beyond their scheme's normal retirement age, providing that their entitlement to these benefits has not been crystallised (i.e. they haven't begun to draw their pension, used the funds to purchase an annuity, or designated them for drawdown).

3.3 The government also introduced a statutory override to enable pension schemes to, in certain cases, override their scheme rules where they would prohibit them from offering flexible access. The government also extended statutory powers for trustees to amend scheme rules where they did not allow schemes to offer the new flexibilities. These measures mean that in most circumstances schemes wishing to offer their members increased flexibility can do so.

3.4 The right to transfer pension savings from one provider to another is an important element of the new pension freedoms enabling individuals to move to another provider or pension scheme to take up the decumulation product[1] that best suits their needs. It also enables individuals with safeguarded benefits to convert those into flexible benefits should they wish.

3.5 Another key aspect of the transfer process is to ensure that scheme trustees and providers carry out the necessary checks to ensure that the pension scheme that the member's benefits will be transferred into is a legitimate pension scheme and not a vehicle for fraud. The introduction of the new flexibilities has created an understandable appetite for ensuring the transfer process is as quick and smooth as possible. This desire needs to be balanced against the need to ensure that scheme trustees and providers have sufficient time to carry out due diligence to ensure that members do not become victims of pension scams and that members understand the implications of the decisions they are taking.

3.6 This chapter examines the current legislative framework for pension transfers and goes on to consider how the process for transferring could be made smoother and more efficient.

3.7 The government welcomes evidence from a range of stakeholders on any issues and barriers to a smooth and efficient transfer process, both for those with flexible benefits and for those with safeguarded benefits. The government would also welcome respondents' views on options for improvements, which both enhance consumers' experience and outcomes in transferring as well as appropriately preserving the ability of providers and schemes to operate effectively.

[1] Pension decumulation is the process of converting pension savings to retirement income and a decumulation product could be an annuity, investment fund or other type of investment used for this purpose.

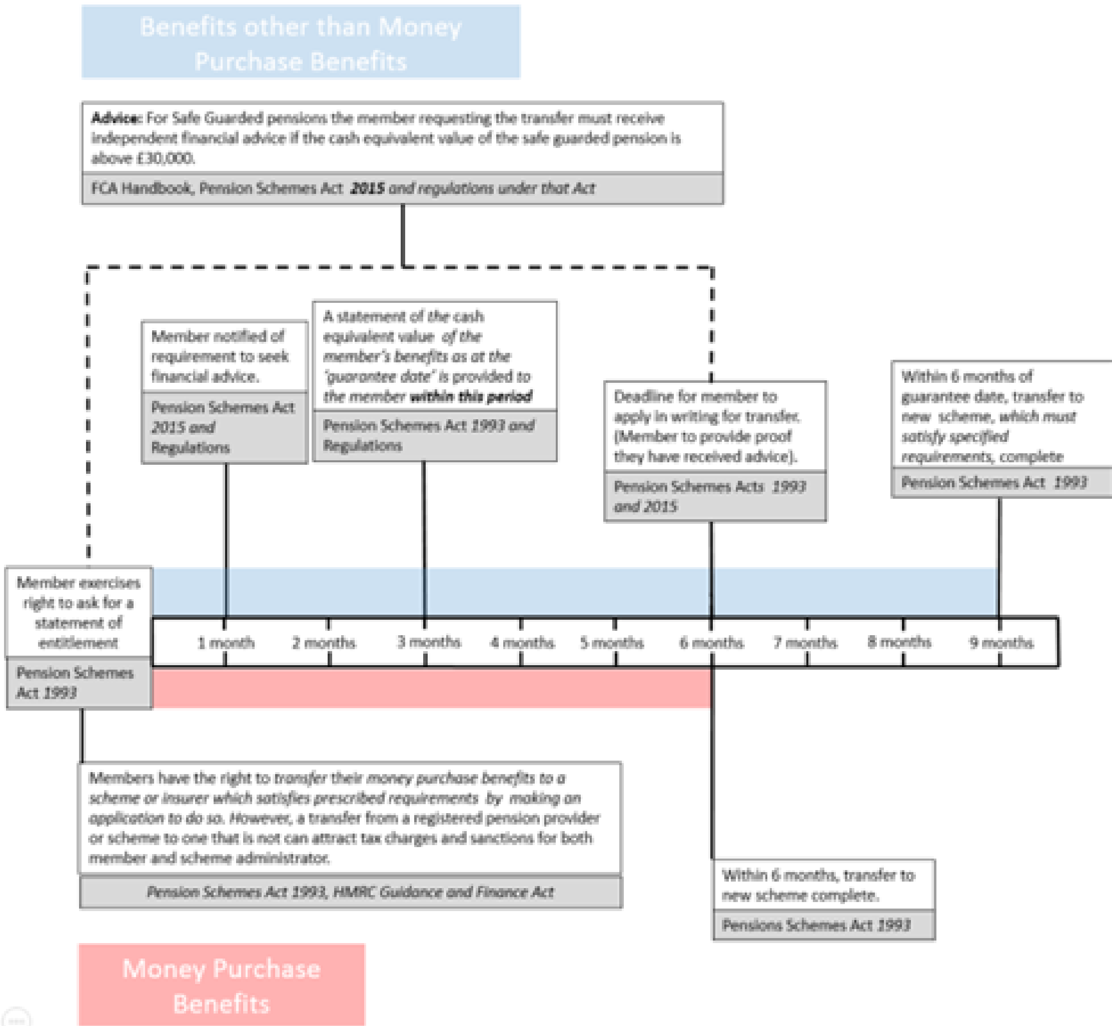
3.8 The FCA and TPR's data gathering exercise with providers and schemes also asks a number of questions on transfers, and this, together with responses to the questions in this consultation document, will help to build the evidence base on further action to improve the transfer process.

Legislative framework for pension transfers

3.9 The evolution of pensions has been a steady, if at times slow, trajectory towards greater transparency, flexibility and choice. Many products date back decades, and a complex legal framework has grown up around the range of products, providers, and services on offer.

3.10 The legislative framework for pension transfers is complex as it needs to set out the detailed process that schemes and providers must follow when converting certain benefit types into a different form, assigning a value to any guarantees and any reductions that schemes may make if a member leaves the scheme early. Box 3.A below sets out the current legal process.

Box 3.A: The statutory process for transferring out of a pension scheme



The full legislative requirements are set out in more detail at Annex B

3.11 Schemes may also be required to liquidate assets before the transfer value can be paid out. These factors combined with the provider's or scheme trustees' duty to ensure that the receiving scheme is a legitimate pension scheme mean that the time taken to complete such a transfer

process is likely to take a matter of months rather than weeks. As this process is irreversible it is important that any decision to streamline the current process takes into consideration these factors, and the important role they play in protecting pension scheme members.

Question 7: How is the current statutory process working in your opinion, and what more could be done to make the statutory process quicker and smoother?

Question 8: What are your views on adopting a separate process for transfers out where benefits are flexible? What might this process look like, and what, in your opinion, might be the risks of doing so?

3.12 There are a number of important legal and regulatory obligations on the ceding scheme, as set out in Box 3.A. The receiving scheme on the other hand has few explicit requirements with regards to the transfer process. There is no statutory requirement on pension schemes to accept transfers in (with the exception of stakeholder pensions which must accept transfers). Many occupational scheme rules may also restrict or prohibit transfers in.

3.13 However, FCA authorised schemes must meet wider FCA requirements - for example ensuring in the case of a non-advised sale, that the product is designed to meet the needs of an identified consumer group, and is targeted accordingly. In addition the receiving scheme is responsible for: ensuring that the transfer is an authorised payment as defined in tax rules (and checking that the ceding scheme is an HMRC-registered pension scheme); and carrying out anti-money laundering requirements. These requirements are aimed at protecting exchequer revenue and protecting against scams and fraud.

Question 9: Do you have any evidence of circumstances where receiving schemes are not accepting pension transfers in under the new freedoms, or are putting in place procedural barriers to doing so?

Question 10: In your opinion, what more could be done to make the process for receiving firms accepting pension transfers in quicker or smoother?

3.14 The government has developed a number of universal principles which should apply to switching from one product to another[2] (for example, when switching utility providers). These are that:

- the process takes as short a time as possible;
- the gaining provider should lead the process;
- the process should be efficient with effective redress mechanisms if things go wrong; and
- unless contractually bound, the process should be free to the customer (this is covered in more detail in chapter two).

3.15 Although not all of these principles are directly applicable or relevant to the pension transfer process, they are echoed for contract based schemes by the FCA's principle of Treating Customers Fairly (TCF), which sets out that consumers should not face unreasonable barriers imposed by firms to change product, switch provider, submit a claim or make a complaint. The government is keen to understand whether and how these universal principles could apply to pension transfers, noting that pension transfers are an irreversible transaction and often a one-off event.

[2] https://www.gov.uk/government/publications/fixing-the-foundations-creating-a-more-prosperous-nation

Box 3.B: Pension scams and investment fraud

Prior to the April 2015 reforms individuals under 55 were the primary target for pension scammers, and victims were typically lured in with promises of a pension loan that would allow them to access their pension savings early.

The introduction of the pension freedoms creates the opportunity for scammers to design new sophisticated investment scams. The government is keen to ensure that vulnerable individuals are protected, and that mechanisms are in place to protect the integrity of tax relief afforded to pension savings.

To help ensure that people understand their options and the risks involved, including potential scams, Pension Wise, with its recognisable distinct branding offers individuals a free and impartial guidance on their retirement options. The government has also made it a criminal offence to impersonate Pension Wise. There are also a number of important mitigations in place to help address ongoing threats:

- a stronger HMRC pension scheme registration process to make it easier to refuse or deregister schemes;
- public information campaigns such as the Scorpion Campaign and the ScamSmart campaign which raise awareness and alert people to the warning signs of pensions and investment scams and the risks of cold calling; and

an industry code of best practice for trustees on transferring pension savings from one pension scheme to another.

3.16 The government's previous legislative amendments ensure that all individuals with flexible benefits have a statutory right to transfer provided that their entitlement to these benefits has not already been crystallised. This is aimed at facilitating transfers from one pension scheme to another. The government is therefore keen to understand the scope for a timely and efficient standard process for transfers that works for the majority of pension savers, and would welcome views on how this might work in practice. For example, one option would be for any regulatory or legislative change to be narrowly scoped so that it only applied to individuals with flexible benefits; and would not pose a disproportionate burden for pension schemes and providers.

3.17 In particular, the government would welcome views on whether this could be done on a voluntary basis with industry, backed by industry commitments; and / or through rules, regulations and legislative change (either to the requirements on providers, or to the sanctions applied for non-compliance, or both). The 7-day switching scheme for current accounts provides a good example of where the industry has put in place a process aimed at making a switching process smoother and more efficient.

Question 11: What, in your view, is the scope for making the process for transfers more efficient through a standard that works for the majority of pension savers? Should this process focus on transfers in relation to flexible benefits? How might this work in practice?

4 Financial advice

4.1 In removing the effective requirement to buy an annuity, the government has given savers the freedom to make their own choices about how they use their retirement savings in later life. Customers may wish to take advice in a range of circumstances when accessing the new freedoms, and are required to do so in certain cases, where their pension has certain valuable features that they need to understand before proceeding with a decision to transfer or convert their benefits into a form which can be taken flexibly.

4.2 Both industry and individuals have raised issues regarding insufficient clarity about when individuals should be required to take financial advice before effecting a transfer, particularly with respect to some pension benefits which contain a guaranteed annuity rate (GAR). In some cases, it is clear that consumers are frustrated by existing legislative and regulatory requirements to seek financial advice in certain circumstances – although it is worth noting that there is no requirement in legislation to follow the advice taken. There are also reports of some firms requiring people with benefits worth less than below £30,000 to take advice, and there may also be cases where firms are requiring advice when not required to do so under pensions legislation, for example if an individual already has flexible benefits and opts for a drawdown product.

Safeguarded benefits

4.3 As part of the new pension freedoms, the government was keen to ensure that as many individuals could access the freedoms as possible. However, the government introduced a safeguard for those with a specific class of benefits known as 'safeguarded benefits'. These 'safeguarded benefits' were judged to provide a particularly valuable and secure retirement benefit that an individual should be informed of before they gave up. Safeguarded benefits include funded defined benefit rights, as well as arrangements which provide a fund but include a guaranteed annuity rate.

4.4 Where a member has safeguarded benefits which derive from a defined benefit pension scheme, they will need to transfer their savings to a defined contribution scheme or convert their benefits within the existing scheme if they want to access their pension savings flexibly. In order to ensure that individuals are fully informed before transferring or converting their safeguarded benefits, the government introduced a requirement for the ceding scheme to check that financial advice had been taken before processing the transfer. This requirement applies where the cash equivalent value of the member's benefits is above £30,000. The nature of the advice was linked to the FCA's advice rules. In the case of defined benefit rights, advice must be provided by a Pension Transfer Specialist[1] as the assessment is complex.

4.5 These requirements do not apply when the cash value of the member's benefits is £30,000 or less. This is to ensure that the cost of obtaining advice is proportionate to the benefits being transferred. The government took the view that policies with guaranteed annuity rates offer a level of security similar to that of a defined benefit scheme, as this level of security is not available from pure defined contribution schemes (that do not have guarantees relating to the rate of pension). In such cases, individuals may be less aware of the security provided by these arrangements, and so the government concluded that individuals should take financial advice to ensure that they fully understand the implications before proceeding with a transfer. However, unlike transfers of other types of defined benefits, the FCA has set out that it is not a

[1] A 'Pensions Transfer Specialist' is an individual appointed by a firm to check the suitability of a pension transfer who has passed the required examinations and training as specified by the FCA and has regulatory permission to perform the function.

requirement for individuals who have a guaranteed annuity rate to seek advice from a Pension Transfer Specialist when transferring their benefits.

4.6 As part of the consultation *Freedom and Choice in Pensions* the government carefully considered the potential impacts of allowing individuals with safeguarded benefits to continue to have a right to transfer from one scheme to another. The government concluded that this statutory right should remain subject to a new requirement to take independent advice, to ensure that people consider the valuable guarantees that they would be giving up before proceeding with a decision to transfer. Although this consultation does not consider the appropriateness of the advice requirement overall, respondents are welcome to provide submissions on this issue under question 14 of this consultation should they wish.

Box 4.A: Pension Wise

From April 2015, eligible individuals with defined contribution savings have been able to access their pension savings in a way that best meets their needs. The government launched the free and impartial Pension Wise service at the same time, to help people understand and navigate their options in the new flexible landscape and make informed and confident decisions. This includes equipping individuals to ask the right questions of their providers and to understand where they might have valuable features about their pension.

Pension Wise specifically encourages people to check with their provider or scheme whether their benefits are 'safeguarded benefits', such as a benefit with a guaranteed annuity rate attached, and explains that if the benefits are safeguarded, they will need to seek financial advice (where the cash equivalent value of these benefits is above £30,000).

Insistent clients

4.7 The government is aware that there are circumstances where customers take financial advice in relation to a safeguarded benefit, and this advice recommends that they should not transfer their pension. In such circumstances, should they wish to proceed with the transfer, their adviser may feel unable to transact on their behalf as they are concerned about potential future liabilities arising from the transfer, despite the customer wishing to do so. Customers in this position are referred to as 'insistent clients'.

4.8 The FCA has recently published a factsheet on the issue of the pension reforms and insistent clients. This outlines the steps that financial advisers should take when advising such clients, including what should be included in the suitability report, and examples of good and bad practice. The factsheet is clear that: "There is no rule to prevent advisers from transacting business against their advice if the client insists"[2].

4.9 The government appreciates that industry and consumers may still be unclear on specific circumstances when independent financial advice is required and wants to understand whether the process for ensuring individuals understand the need for and importance of independent financial advice is operating as intended.

Question 12: What has been the impact of the legal requirement to receive independent advice on the process for transferring safeguarded benefits?

[2] http://www.fca.org.uk/static/documents/factsheets/fs035-pension-reforms-insistent-clients.pdf

Question 13: How could the process for seeking advice in relation to safeguarded benefits be made quicker and smoother, and clearer for individuals, firms, and advisers?

Wider issues

4.10 The government appreciates that there may be circumstances when individual schemes and providers may require independent advice in relation to a particular product. However, the government does not want such requirements to become a barrier to accessing products and therefore wishes to avoid the situation where schemes and providers may feel forced to require advice where it is not necessary.

4.11 In order to understand more about where schemes and providers are requiring advice, including where it is not required by law, the FCA and TPR are gathering evidence on how the advice requirement for safeguarded benefits is being applied, and how this interacts with schemes and providers' decisions on requiring advice. The government will examine the evidence base alongside FCA and TPR in order to form a view on the next steps in this area.

5 Next steps

5.1 As made clear when the new reforms were announced, the government and the regulators are monitoring progress closely to ensure that the new system works in practice and that the industry helps hard working people get the most out of these historic reforms.

5.2 Alongside this consultation, and in line with their objectives to ensure effective competition and appropriate consumer protection, the FCA and TPR are carrying out a comprehensive evidence gathering exercise, about any barriers faced by consumers who are seeking to access their pension savings, including on the existing processes for pension transfers and any fees and charges that members might incur if they decide to leave their scheme early. These requests, which are formal regulatory requests to firms which the FCA and TPR regulate, were issued on 1 July and responses are due later in the summer. The government will join up with the FCA and TPR on stakeholder engagement plans relating to the regulators' information requests to providers and schemes.

5.3 More widely, the FCA have committed to analysing closely developments in the decumulation market, including but not limited to the types of products developed and charges faced by consumers taking advantage of the new flexibilities. The FCA intend to return to pension schemes and providers later in the year to request further information about the development of this market.

5.4 The government would also welcome submissions on any wider issues and challenges that you may be aware of regarding the new pension freedoms as part of this consultation.

Question 14: What evidence do you have of wider issues regarding the implementation of the pension flexibilities that need to be addressed?

Further information

5.5 This consultation document invites interested parties to comment, over a 12-week period, on the issues set out herein. This consultation will close on 21 October 2015.

5.6 This paper is available at www.gov.uk/government/publications.

5.7 The government welcomes responses to the questions raised in this consultation; these are summarised in Annex A. Respondents are encouraged in their responses to add any additional information they feel is relevant to this consultation.

5.8 Responses to this consultation should be received by 21 October 2015. Please ensure that responses are sent in before the closing date. The government cannot guarantee that responses received after this date will be considered.

5.9 Responses to this consultation should be sent to:

Pension Transfers and Exit Charges Consultation, Consumer Issues Unit, HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ.

Alternatively, please send responses by e-mail to:
PensionTransfersandChargesConsultation2015@HMTreasury.gsi.gov.uk.

When responding, please state whether you are doing so as an individual or on behalf of an organisation.

Confidentiality

5.10 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

5.11 If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, among other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury.

5.12 HM Treasury will process your personal data in accordance with the Data Protection Act and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

A Summary of questions

Exit charges and fees

Question 1: Do you have any evidence as to the scale and quantum of fees and charges that members might incur for leaving their scheme or accessing their benefits early?

Question 2: Are you aware of any evidence of charges that are levied at, or above, an individual's selected pension age? Are there any examples of customer detriment as a result of late exit penalties, and charges at an individual's selected pension age?

Question 3: In your view, what would constitute an 'excessive' or unfair early exit charge? Please include any fees and charges that you would consider to be outside this definition and why.

Question 4: Are you aware of any evidence of exit charges impacting on individuals' decisions to access the flexibilities? Are there any examples of individuals losing out as a result of not being able to access the flexibilities in these circumstances?

Question 5: How could the simplicity and transparency of market value adjustments and other investment deductions (as opposed to exit charges) be improved to increase customer understanding of such fees?

Question 6: The government would welcome views on the pros and cons of each of the 3 approaches to addressing excessive early exit fees set out in paragraphs 2.26 to 2.30. In particular, the government would be interested in views on particular components of an exit fee or other charges that should be considered to be in scope of any limit, and evidence on what might be the right level for any cap.

Transfer process

Question 7: How is the current statutory process working in your opinion, and what more could be done to make the statutory process quicker and smoother?

Question 8: What are your views on adopting a separate process for transfers out where benefits are flexible? What might this process look like, and what, in your opinion, might be the risks of doing so?

Question 9: Do you have any evidence of circumstances where receiving schemes are not accepting pension transfers under the new freedoms, or are putting in place procedural barriers to doing so?

Question 10: In your opinion, what more could be done to make the process for receiving firms accepting pension transfers in quicker or smoother?

Question 11: What, in your view, is the scope for making the process for transfers more efficient through a standard approach that works for the majority of pension savers? Should this process focus on transfers in relation to flexible benefits? How might this work in practice?

Financial advice

Question 12: What has been the impact of the legal requirement to receive independent advice on the process for transferring pensions with safeguarded benefits?

Question 13: How could the process for seeking advice in relation to safeguarded benefits be made quicker and smoother, and clearer for individuals, firms, and advisers?

General

Question 14: What evidence do you have of wider issues regarding the implementation of the pension flexibilities that need to be addressed?

B The transfer process

B.1 This annex sets out more fully the legislative requirements governing the process of transferring between pension schemes, the essential features of which are set out in Box 3A.

General

B.2 Transfer rights are provided for in Chapter 1 of Part 4ZA of the Pension Schemes Act 1993, but many schemes will provide rights for members to transfer their benefits over and above those set out in statute. The following conditions must be met for the Chapter to apply:

- Condition 1 – the member has accrued rights to any category of benefits (i.e. money purchase, flexible benefits other than money purchase benefits and benefits that are not flexible benefits) under the scheme rules – section 93(2);
- Condition 2 – no crystallisation event (i.e. the member has not begun to draw their pension, designated the funds as available for drawdown or used the funds to purchase an annuity or insurance policy) has occurred in relation to the member's accrued rights to benefits in the category of benefit the member wants to transfer – section 93(3); and
- Condition 3 – the member is no longer accruing rights to benefits in that category and, for benefits that are not flexible, the member stopped accruing those rights at least one year before normal pension age – section 93(4).

For benefits other than money purchase benefits[1]

B.3 The member applies to the trustees or managers for a statement of entitlement – section 93A(1) of the 1993 Act.

> "Statement of entitlement" – a written statement of the amount of the cash equivalent at the guarantee date of the member's transferrable rights that are the subject of the application for a statement of entitlement – section 93A(3).
>
> "Guarantee date" – the date by reference to which the value of the cash equivalent is calculated. It must fall between the date of the application and the date the statement of entitlement is provided – section 93A(4) – and also within 10 days ending with the date on which the statement of entitlement is provided to the member – regulation 6(2) of the Occupational Pension Schemes (Transfer Values) Regulations 1996.

B.4 Where the member is transferring safeguarded benefits (i.e. where section 48 of the Pension Schemes Act 2015 applies), the member cannot transfer their benefits to a scheme which provides flexible benefits, or a cash sum, unless the member first receives independent financial advice so that they understand the value of the rights given up. The scheme trustees or managers must explain to the member that, unless one of the exceptions applies, they are required to check that the member has received independent financial advice, and what the member must do to confirm this (see regulations 5 to 8 of the Pensions Schemes Act 2015 (Transitional Provisions and Appropriate Independent Advice) Regulations 2015.

B.5 The trustees or managers must provide this explanation within 1 month of the member asking how to carry out a transfer or making an application for a statement of entitlement –

[1] As well as traditional defined benefits, this category includes those flexible benefits which are 'cash balance benefits', characterised as money purchase under tax legislation but non-money purchase under pensions legislation.

regulation 8(3) of the 2015 Regulations. The statement of entitlement must be provided within 3 months of the date of the application[2] the trustees or managers should also confirm, when they provide the statement of entitlement or valuation, if they have not already done so, whether independent financial advice is required or whether the exception applies – regulation 9(1)(b) and (4)(a) of the 2015 Regulations.

B.6 When the member has received the statement of entitlement, the member acquires a right to take the cash equivalent shown in that statement – section 94(1) of the 1993 Act.

B.7 The member makes an application in writing requiring the trustees or managers to use the cash equivalent – section 95(1). In the case of a transfer, the member must request that the amount of the cash equivalent is transferred to a scheme that is willing to accept the payment and which satisfies prescribed requirements – section 95(2)(a) and (b) and 95(3)(a) and (b). The application must be made within 3 months of the guarantee date and no later than one year before the member attains normal pension age – section 95(1A)

B.8 Where the member is converting safeguarded benefits over the value of £30,000, the member must confirm to the trustees that independent financial advice has been received. This confirmation must be provided within 3 months of the date of the statement of entitlement – regulation 6(b) of the 2015 Regulations.

B.9 Where the trustees receive an application under section 95, they must do what is required within 6 months beginning with the guarantee date – section 99(2)(a) of the 1993 Act.

For money purchase benefits

B.10 A member who has transferrable rights and satisfies the conditions in section 93 of the Pension Schemes Act 1993 acquires a statutory right to take their cash equivalent – section 94(2).

> "Transferrable rights" are any rights in relation to a category of benefits where the Chapter applies – that is, any rights that meet the conditions outlined at B.2 – section 93(11)(b).

B.11 The member is able to ask the trustees or managers of the scheme for a valuation of their benefits under the 1996 Regulations or the Occupational and Personal Pension Schemes (Disclosure of Information Regulations) 2013. They may choose to seek guidance or advice on what to do with their benefits. They then make an application in writing requiring the trustees or managers to use the cash equivalent in whichever of the permitted ways they choose – section 95(1) of the 1993 Act. In the case of a transfer, the member must request that the amount of the cash equivalent is transferred to a scheme that is willing to accept the payment and which satisfies prescribed requirements – section 95(2)(a) and (b) and 95(3)(a) and (b).

B.12 Where the trustees receive an application under section 95, they must do what is required within 6 months of the date of the application – section 99(2)(b).

[2] This applies to occupational pension schemes only.

HM Treasury contacts

This document can be downloaded from
www.gov.uk

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