



Department
for Work &
Pensions

Capping early exit charges for members of occupational pension schemes

Ensuring a fair and consistent approach
across all defined contribution pensions

Public consultation

May 2016

Contents

	Page
Introduction	
- Purpose of consultation	2
- Who this consultation is aimed at	2
- Scope of consultation	2
- Duration of consultation	2
- How to respond to the consultation	2
Foreword	4
Chapter 1 provides background information on the need for an early exit charge cap for occupational pension schemes	5
Chapter 2 sets out the key principles underlying the design of the cap and explores how it might be defined	7
Chapter 3 looks at what charges levied upon exit should be excluded from the cap.	12
Chapter 4 explores the level and scope of the cap	15
Chapter 5 sets out the next steps following this consultation	20
Annex A provides a summary of the questions in the consultation	21
Annex B sets out how we consult, covering:	23
- consultation principles;	
- feedback on the consultation process;	
- freedom of information	

About this consultation

Purpose of the consultation

This consultation is seeking views on proposals to introduce a cap on early exit charges imposed by providers of occupational pension schemes when a member leaves the scheme early in order to access their pensions flexibly. The responses to this consultation will inform legislative changes that will bring the cap into effect.

The Government believes that any cap should apply across both occupational and personal pension schemes. This consultation is complemented by the work being undertaken by the Financial Conduct Authority on the level of the cap for personal pension schemes and by HM Treasury on the nature of the exemptions for its scope.

Who this consultation is aimed at

- pensions industry bodies and professionals;
- trustees or scheme managers;
- pension scheme members and beneficiaries;
- employers and representative organisations; and
- any other source.

Scope of consultation

Pensions policy is a reserved matter under the devolution settlement and therefore no devolved administration interests arise in relation to Great Britain. Northern Ireland makes their own legislation in relation to pensions.

Duration of the consultation

The consultation period begins on 26 May 2016 and runs until 16 August 2016.

How to respond to this consultation

Please send your response, preferably by e-mail to:

earlyexit.chargesconsultation@dwp.gsi.gov.uk

Or by post to :

Mike Moore
Department for Work and Pensions
Private Pensions
1st Floor
Caxton House
Tothill Street

London
SW1H 9NA

Please ensure your response reaches us by : 16 August 2016.

When responding please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of an organisation please make it clear who the organisation represents and where applicable, how the views of members were assembled.

Any queries about the subject matter of this consultation should be addressed to :

Mike Moore at : earlyexit.chargesconsultation@dwp.gsi.gov.uk

Foreword

The pension freedoms have given people with defined contribution pensions significantly more options and flexibility about how they fund their retirement. No longer are most people effectively forced down the one size fits all route of annuity purchase, which may not be the best option for some.

However, in order to ensure that the people are able to take advantage of the new freedoms we must make sure that barriers are removed so that people can plan and take their pension savings in a way that best suits them and their individual circumstances.

We know that early exit charges are creating a financial barrier for a significant minority, and in some cases these charges are effectively preventing people from exercising the freedoms altogether.

Today's consultation paper confirms that we will act to protect all of those eligible to help them access the freedoms, by capping early exit charges that trustees or managers and third parties who administer occupational pension schemes can charge. I am committed to putting choice back in the hands of individuals who have acted responsibly and saved hard for their retirement and to ensuring that individuals have a fair chance to plan later life income in a way that will best suit them.

Schemes and providers who continue to charge early exit charges should be starting to plan for these changes which will be introduced next year. I would also expect those providers who operate both occupational and personal pensions to align their charges so that all consumers are treated equally, regardless of whether they have saved into an occupational or personal pension scheme.

We will legislate to crack down on these prohibitive charges in occupational pension schemes and I would like to see schemes beginning to reduce their exit charges in advance of being forced to do so.

The cap announced today will help to put savers back at the heart of the pension saving system. The Financial Conduct Authority and The Pensions Regulator will continue to work with Government to ensure that all consumers can benefit from the cap, regardless of the pension scheme they have saved into.

The Baroness Altman CBE

Minister of State for Pensions

CHAPTER 1 INTRODUCTION

Purpose of this consultation

1.1 Since the introduction of the pension freedoms in April 2015, the Government has become aware that individuals are facing a range of potential barriers when seeking to access their savings under the pension freedoms. This includes incurring early exit charges, which reports indicate might be acting as a barrier to some people accessing their pension savings and being able to make the most appropriate choices for their own personal circumstances.

1.2 To determine the scale of the issues and the need for intervention in July 2015, the Government carried out a consultation entitled “*Pension transfers and early exit charges*”¹. This consultation looked at and sought views on:

- early exit charges and whether consumers faced unjustifiable charges when moving scheme in order to access their pension savings early;
- possible approaches to address early exit charges for those seeking to access the freedoms;
- ways of making the process for transferring pension savings from one scheme to another smoother and more efficient, and
- how to ensure that there was greater clarity around the circumstances in which someone should seek financial advice.

1.3 The consultation explored options to address the possible barriers to people taking money from their pot or switching their pensions to take advantage of the new pension freedoms which had come into effect in April that year. This included early exit charges, the process for transferring pensions from one scheme to another and the circumstances in which someone should be required to seek financial advice.

1.4 In February 2016, the Government responded to the consultation and announced that:

- it would introduce legislation in the Bank of England and Financial Services Bill to amend the Financial Services and Markets Act 2000 (FSMA). This amendment would give the Financial Conduct Authority (FCA) a duty to make rules requiring relevant firms to limit early exit charges imposed in relation to personal and stakeholder pension schemes.
- the FCA would set out its approach with a view to implementing its duty to cap early exit charges before the end of March 2017.

1

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/449861/PU1847_Pensions_transfers_v4.pdf

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/498871/pension_transfers_and_early_exit_charges_response.pdf

- In parallel with the FCA process, the Government would consider how existing powers to limit pension charges could be used to implement a comparable cap on early exit charges in occupational pension schemes.
- The Pensions Regulator (TPR) would consider the work of the FCA as they developed the design and level of the cap for FCA regulated schemes to ensure that any relevant concerns in respect of occupational pension schemes are appropriately addressed for all consumers.

1.5 The Government recognises that industry practices have changed and the introduction of the pension freedoms means the significance of exit charges might be much greater now compared to when the freedoms were first agreed. In the context of the greater access and choice introduced by the pension freedoms some early exit charges pose a barrier to individuals accessing their savings flexibly and the Government has concluded that action needs to be taken to limit these charges. Evidence collected by TPR shows that exit charges are being applied in occupational pension schemes. The Government is committed to ensuring that all pension scheme members are protected from the deterrent effect of early exit charges regardless of the type of pension scheme that they are in.

1.6 This consultation builds on the Government response to the “*Pension transfers and early exit charges*” consultation. It recognises the work the FCA are doing to develop the level of the cap for personal pension schemes and considers what action is required to implement a comparable cap for occupational pension schemes. It sets out the Government’s current intentions to legislate with regard to the introduction of a cap on early exit charges in occupational pension schemes that contain flexible benefits². The Government will seek to legislate in relation to the necessary changes to primary legislation in the forthcoming Pensions Bill.

1.7 This consultation draws upon evidence gathered by the FCA and two TPR surveys on occupational pension schemes published alongside this consultation. It should be considered alongside FCA’s consultation document CP16/15 ‘Capping early exit pension charges’ published on 26 May 2016 which sets out the approach the FCA have adopted to determining the level of the cap in relation to personal pensions. This consultation also considers the definition of early exit charges that should be applied in occupational pension schemes, statutory exclusions from that definition (for both personal and occupational pensions) and how the cap should be implemented in occupational pension schemes.

1.8 This consultation document invites interested parties to comment over a 12 week period and closes on 16 August 2016.

1.9 The Government welcomes views on the questions set out in Annex A, which cover issues and options in relation to early exit charges.

² Flexible benefits are defined in Section 74 of the Pension Schemes Act 2015 and are intended to cover cash balance benefits and money purchase benefits.

CHAPTER 2 PRINCIPLES FOR CAPPING EXIT CHARGES IN OCCUPATIONAL PENSION SCHEMES

2.1 This Chapter:

- sets out the key principles that the Government will use to assess what the scope and level of the early exit charges cap should be;
- considers what the definition of exit charges should be, and
- discusses other matters that the Government will need to take into account to ensure that the cap operates as intended for occupational pension scheme members.

Key principles for creating an effective cap

2.2 The Government has considered the most effective means of capping early exit charges that pension scheme members may incur, and has developed four key principles to inform how it will implement the cap on early exit charges in occupational pension schemes.

2.3 The four principles are:

- 1) the legislation implementing the cap is not intended to prevent schemes trustees, administrators and third parties from charging early exit fees in existing schemes. The legislation should ensure that consumers wishing to access, convert or transfer their pension savings to a form that can be taken flexibly have an appropriate degree of protection.
- 2) The cap will only apply to charges faced by members who are eligible to access the pension freedoms.
- 3) The cap will apply to scheme members with new and existing pensions who are eligible to access the freedoms.
- 4) As far as possible, the cap for occupational and personal pension scheme members will operate in the same way, to aid consumer understanding.

2.4 These principles flow from the outcome of the HM Treasury's consultation on pension transfers and early exit charges, and data gathered by the FCA and TPR, which has informed the Government's thinking on what parameters the cap should have.

2.5 FCA data from September 2015 showed that around 16% of consumers eligible to access their pension savings would incur an early exit charge if they opted to leave the scheme before the selected retirement age in personal pension schemes. The majority (nearly 80%) of those where a percentage charge would apply, face a charge of up to 5% of the fund value³.

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

2.6 The TPR survey of flexible pension access⁴, covering July to August 2015 showed that 11% of schemes that responded to the survey imposed at least one exit charge, providing clear evidence that early exit charges are occurring in occupational pension schemes. The Government recognises that this survey may not have captured the full extent of exit charges across all occupational pension schemes. Where reported the median fixed fee charged was £200 and the median percentage charge was 5%. The 2016 TPR survey⁵ also confirms the existence of early exit charges in occupational pension schemes.

Scope of the early exit charges cap

2.7 Following the July 2015 consultation, the Government concluded that, in some cases, early exit charges were acting as a deterrent to those seeking to take their pension savings flexibly, and that the situation could be improved for this group by capping these charges. This would protect the principle that all consumers who are eligible to access the freedoms should be able to do so. The Government acknowledges that it is generally undesirable to interfere with existing contractual rights and, therefore, it can only be justified where it is necessary to achieve important public policy goals, and where action is proportionate and in the public interest. As set out in previous consultations, in the Government's view, the freedoms mark a sufficiently fundamental change in the pensions landscape that imposing a limit on early exit charges meets this test.

2.8 The pension freedoms are only available to those aged 55 and over. The Government has carefully considered whether introducing a cap focused on access to the pension freedoms would constitute age discrimination. It has concluded that it does not. Limiting access to pensions based on age is a long-standing position, which recognises that pensions are long-term savings products which bring personal and societal benefits. Existing policies, such as the 55% unauthorised payment charge, reflect this.

2.9 The Government has also considered the implications for individuals under the age of 55 who are able to access their pensions early due to exceptional circumstances. For example, in the case of serious ill health, evidence gathered to date suggests that, generally, early exit charges will not be imposed, or will be waived in such cases. In addition, evidence gathered from pension providers to date suggests that scheme members will not incur exit charges if they choose to access or transfer their pension savings to another scheme after their selected retirement date.

Question 1: Is there any reason why Government should not adopt this approach in relation to occupational pension schemes?

2.10 The Government understands that occupational pension schemes which are administered by third parties are more likely to apply an early exit charge, where scheme members decide to leave before their agreed retirement date. Exit charges

⁴ TPR: Survey of flexible pension access, September 2015

⁵ www.tpr.gov.uk/exit

can be imposed either directly by the scheme trustees or managers as a consequence of contractual arrangements they have entered into, for example, with a third party administrator.

2.11 Despite the different reasons for such charges, the Government, therefore, intends that the early exit charges cap will apply to charges imposed either by scheme trustees or managers themselves or as a consequence of the contracts they have entered into in order to ensure that the cap delivers adequate protection to occupational pension scheme members who are eligible to access their pension flexibly. This may involve duties on others to disclose information about early exit charges, which is discussed in more detail in Chapter 4.

Question 2: 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.

Definition of an exit charge

2.12 In order for the cap on occupational pension schemes to work effectively the Government will need to set out in legislation which components constitute an early exit charge. The Government is minded to use elements of the existing definition that relates to personal and stakeholder pension schemes, which is set out in Section 33 of the Bank of England and Financial Services Act 2016. The Act introduces a provision giving the FCA a duty to make rules to cap early exit charges by inserting new section 137FBB in the Financial Services and Markets Act 2000 (FSMA), subsection (6) of which defines an early exit charge as follows:

“(6) Subject to subsection (8) an early exit charge⁶, in relation to a member of a pension scheme, is a charge which—

(a) is imposed under the scheme when a member who has reached normal minimum pension age takes the action mentioned in subsection (7), but

(b) is only imposed, or only imposed to that extent, if the member takes that action before the member’s expected retirement date.

(7) The action is the member taking benefits under the scheme, converting benefits under the scheme into different benefits or transferring benefits under the scheme to another pension scheme.

Question 3: Is there any reason why such a definition of early exit charges would not be suitable in relation to occupational pension schemes?

Source of early exit charges

⁶ Subsection (9) defines “charge” as follows: in relation to a member of a pension scheme, includes a reduction in the value of the member’s benefits under the scheme.

2.13 The Government recognises that a cap on early exit charges may include a number of components. In forming its view on how to proceed, the Government has considered the source of early exit charges and how the various interested parties may be affected.

2.14 With respect to occupational pension schemes, the Government understands that charges are typically administered in two ways, either:

- directly by the trustees or managers of the pension scheme, or
- by third parties with whom scheme trustees or managers enter into contracts to administer all or certain aspects of the scheme.

2.15 In developing its approach, the Government has sought to consider the range of charges that pension providers and scheme trustees or managers incur when setting up and running a pension scheme, as well as to understand when and how these might be recouped from scheme members either through upfront joining charges, on-going charges or charges at the point of exit, or a combination of these.

2.16 Our understanding is that there are three main ways that pension schemes and administrators typically seek to recover their set up costs:

- i. Set up costs paid up front by each saver with no exit charges.
- ii. All savers paying the same on-going charge as a proportion of their funds, (for example, through an annual management charge) with no joining or exit charges, although on-going charges can increase.
- iii. Set up costs paid over the lifetime or at exit where the member decides to leave early.

2.17 The Government understands that in some cases pension providers and third parties may seek to impose early exit charges to recoup losses relating to the future contributions from those members, including future annual management charges. Given the wide range of fees that can make up an “early exit charge”, and the vast range of contractual variations it remains unclear exactly which components may make up an early exit charge in a way that can be defined consistently. This is not to suggest that in levying early exit charges, pension schemes have acted inconsistently with their contractual entitlements within the current legal framework; but the Government would be keen to understand more about the nature of these contractual terms.

2.18 All those involved in setting up and running a pension scheme will have had to decide which of these charging structures to adopt. Our current evidence suggests that the primary source of early exit charges is the contractual arrangements which trustees or managers have entered into, rather than as a consequence of the requirements set out in the trust deed and rules. The Government is keen to explore whether this is indeed the case.

Question 4: 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?

CHAPTER 3 EXCLUSIONS TO THE CAP

3.1 This Chapter considers HM Treasury’s proposed regulations aimed at excluding Market Value Adjustments (MVAs) in personal pensions from the exit charges cap. It asks questions about:

- the approach to excluding MVAs from the cap; and
- a discussion of terminal bonuses; and
- MVAs in occupational pension schemes.

Rationale for excluding MVAs from exit charges

3.2 MVAs, sometimes referred to interchangeably as Market Value Reductions, are adjustments generally found in “with profits” products or those similar to “with profits” products, which are offered by insurers directly to members via personal pension schemes or indirectly via occupational pension scheme investments. They are reductions that may be made to the nominal value of a member’s pension benefits when they exit a pension scheme early in order to more closely align them with the market value of the assets which those benefits are comprised of at the point at which the member exits the scheme.

3.3 In its consultation “*Pensions transfers and early exit charges*” (July 2015) and in the consultation response, the Government made it clear that it did not consider MVAs to be exit charges for the purposes of the FCA cap. This is because, although they may appear as a reduction to the consumer, the aim of an MVA is to return an individual to their ‘share’ of the pension scheme at the point at which they exit, as opposed to a nominal figure that may be quoted to them in their pension statement. We understand that where an MVA is properly applied it will follow accepted actuarial practices, for example, it would be consistent with the Insurance Technical Actuarial Standard (Part E - The Exercise of Discretion in Long Term Insurance Business) and will be applied on a consistent basis to all scheme members.

3.4 The investments to which MVAs may be applied are long-term in nature and backed by asset models that assume continued participation to a particular point, usually the selected retirement age. Consequently, early exits can disrupt providers’ long-term asset models which are built to incorporate long-term factors such as changes in interest rates. This is demonstrated by the fact that MVAs tend to reduce or fall away entirely as a saver approaches their selected retirement date.

3.5 Providers may use different criteria for applying MVAs, for example, when :

- a policy is surrendered (partly or wholly),
- when benefits are taken from a pension policy before the selected retirement date,
- when an investment is switched out of a with-profits investment fund into another fund (which could include the conversion of a with profits annuity to a non- profit annuity), or when

- a withdrawal is taken.

Approach to regulation

3.6 In order to make it clear that MVAs should not be considered exit charges for the purposes of the exit charge cap and avoid any potential ambiguity, the Government will make regulations pursuant to subsection 137FBB(8) in the Financial Services and Markets Act 2000 (FSMA), in order to specify that MVAs are not to be treated as early exit charges for the purpose of the cap on early exit charges provided by that section. It is also our intention to apply this definition of MVAs to occupational 'with-profits' pension schemes.

3.7 The broad approach that these regulations will take is to specify that an adjustment to the value of a member's benefits will not be treated as an early exit charge if the adjustment either:

- reflects a difference between the indicative value of a member's benefits (for example, the value of a member's benefits under a pension scheme as last communicated to the member prior to the (point of surrender))and their market value at the point of surrender, or
- is made to smooth market fluctuations, or as a consequence of the previous application of adjustments to smooth market fluctuations,

and providing that certain conditions are met. The proposed conditions are that the adjustments are made both:

- for the purpose of ensuring that the value of the scheme is fairly distributed between its members,
- in a manner which aims to adjust the value of the member's benefits in order to reflect the member's asset share, and
- in accordance with generally accepted actuarial practice and all relevant regulatory requirements.

Terminal bonuses

3.8 When the Government initially consulted on exit charges in July 2015, it was set out that the Government did not propose to consider in detail the position with regard to MVAs or terminal bonuses as part of the exit charges consultation process. At the time, we said that :

*"[a] 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"*

3.9 However, it has since come to light that there may be cases where a scheme member is entitled to a terminal bonus - either as a result of an express entitlement or as a reasonable expectation arising under the scheme.

3.10 In order to remove any ambiguity regarding the status of terminal bonuses where an individual would have a legal entitlement to those assets it is, therefore, proposed that the regulations should make clear that adjustments made to the value of a members benefits that a 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) are not within the category of adjustment described above (as MVAs), i.e. :

Adjustments to the indicative value of a member's benefits are not MVAs where the member has a reasonable expectation that they are entitled to the value of those benefits.

3.11 This is to avoid any potential ambiguity in the treatment of members' benefits to which they may have a reasonable expectation under the existing legal framework and is not expected to lead to a difference in outcome for individuals of firms regarding an individual's legal rights under the scheme.

3.12 When legislating to cap early exit charges in occupational pension schemes the Government intends to ensure that a comparable approach to that adopted in relation to personal pensions applies.

Question 5: Do you have any comments on the proposed definition of MVAs? Are there other features of an MVA that would need to be captured in any definition?

Question 6: Do you have any comments about the proposed approach to "terminal bonuses" and their exclusion from the definition of MVAs?

Question 7: Would a similar definition of MVAs assist trustees or managers to determine what was in scope of an exit charge?

CHAPTER 4 LEVEL AND APPLICATION OF THE CAP

4.1 This Chapter considers:

- what the proposed level of the cap should be;
- the risk of waterbed effect (providers recovering these costs elsewhere);
- proposed compliance and enforcement regime for the cap.

The proposed levels of the cap

4.2 The Government needs to strike the right balance between respecting contractual property rights and ensuring members of occupational pension schemes are able to access their pension. The intention, therefore, is not to prevent pension schemes from applying early exit charges under existing arrangements but to ensure they are set at an appropriate level so that members can access the pension freedoms.

4.3 In its response to the public consultation "*Pension transfers and early exit charges*", the Government outlined the reasoning behind implementing a legislative cap on exit charges. This was based on the evidence provided by respondents to a consumer survey, with 70% favouring a legislative cap and a further 6% supporting a flexible cap (in circumstances to be determined by the FCA). In light of this and for the sake of simplicity the Government is not minded to introduce a flat monetary cap.

4.4 The Government has accepted that it is reasonable to recover an element of costs flowing from early exit and is not proposing a complete ban on early exit charges in existing schemes. It also believes that the definition of an early exit charge will allow the continued recovery of administration costs incurred in processing an exit. The TPR survey of flexible pension access showed the median fee charged by those who responded to the survey was £200 and the median percentage fee was 5%. Broadly similar ranges were found in the more recent survey. Although some exit charges appear to be expressed as a monetary amount the Government is of the view that it would be complex to introduce a monetary cap alongside a percentage cap.

Question 8: 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?

4.5 In their consultation paper 16/15 "*Capping early exit pension charges*" published on 26 May 2016, the FCA set out the methodology they have used to determine the level of the cap for personal pensions. They use data collected on the number of member transfers, which are a proxy for accessing the pension freedoms, and show that the higher the exit charge, the smaller the proportion of members that transfer. They then calculate the number of members expected to access their pensions early for different levels of exit charge cap, and estimate the associated

costs to providers from charges foregone. The consultation paper proposes a cap levels of:

- 1% for existing personal pension contracts; and
- 0% for new personal pension contracts

4.6 The Government has modelled the potential impact of various cap levels on existing occupational pension schemes. The detail of this analysis is contained in the Impact Assessment “*Introducing a cap on early exit charges in trust-based occupational pension schemes*” published alongside this consultation. This draws on both the FCA’s data collection and the recent survey conducted on behalf of TPR. The results showed that 4% of the schemes that took part in the survey applied an exit charge to members aged 55 and over who chose to access their savings before their normal retirement date⁷. This is a lower prevalence than found by the FCA for contract based schemes, however it must be recognised that the response rate to TPR’s survey was low and therefore the results may not be representative.

4.7 Despite the difference in volume of schemes and members facing exit charges, the analysis shows broadly similar conclusions to the FCA analysis.

4.8 Given the lack of evidence from the FCA and TPR suggesting otherwise; the Government sees no reason why a comparable cap to that proposed by the FCA should not be applied to occupational pension schemes. A key benefit of legislating for the same cap on occupational pension schemes as personal pension schemes is that providers which service both will be able to align their systems rather than have different processes for occupational pension schemes.

4.9 Therefore, the Government intends to legislate to mirror the FCA’s proposed levels of cap for occupational pension schemes.

4.10 The Government believes that the cap for existing contracts strike the right balance between effective competition and appropriate consumer protection. The intention, therefore, is not to prevent pension schemes from applying an early exit charge in existing schemes but to ensure the appropriate level is set so that service providers retain the ability to recoup reasonable costs incurred in setting up and running a pension scheme for the member without deterring members from accessing the pension freedoms.

4.11 Evidence suggests that exit charges largely exist in schemes that were set up in the 1980s and 1990s. Going forward, the Government does not believe that it is necessary or desirable to impose early exit charges on new contracts, notwithstanding the need to impose reasonable administration charges to process an early exit from a scheme which is out of scope of these proposals to cap exit charges.

Question 9: Is there any evidence to suggest that occupational pension schemes should apply a different level of cap to that applied to personal pension schemes?

⁷ This is based on new survey from TPR but excludes UFPLS charges and MVAs

Question 10: Do you agree with the levels of the proposed cap?

Application and Compliance

4.12 The Bank of England and Financial Services Act 2016 includes provision that makes it clear that the FCA can make rules with retrospective effect. The Government intends to amend pensions legislation in the forthcoming Pensions Bill to make clear that the cap for members of occupational pensions can apply with retrospective effect. This will ensure that the cap can apply to the contracts that trustees or managers of the scheme and any third parties who impose exit charges have entered into, including where contracts were entered into before the date on which the cap takes effect. Subsection 4 reads as follows:

“The rules made by virtue of subsection 1(a) must prohibit the imposition of the charges after those rules come into force, whether the relevant pension scheme was established before or after those rules (or this section) came into force”

4.13 The Government recognises that the proposed cap, although applicable to occupational pension schemes, will impact on the contractual arrangements they have entered into with third parties. The recent TPR survey⁸ suggested that where exit charges exist in occupational pension schemes they are more often applied by an external administrator rather than by the trustees or in-house administrators. In assessing the appropriate level of the cap the Government has sought to balance the interests of those third parties with the interests of members.

4.14 The Government wants to avoid a situation where any exit charges that are reduced by the proposed cap are not simply moved elsewhere or rebranded. In managing their scheme trustees or managers should be familiar with and understand the impact of the terms and conditions of contracts with service providers. Clearly it would not be in the interests of scheme members for trustees or managers to renegotiate contracts where other charges have been inflated by service providers to compensate for a cap on exit charges.

4.15 The Government would also expect trustees and service providers to work together when renegotiating or amending contracts early because of the implementation of the charge cap. If there is evidence that pension schemes are increasing costs elsewhere in order to compensate for foregone exit charges the Government and regulators will consider what action may be necessary to ensure that members are protected.

4.16 The Government is interested in the views of respondents on this issue, specifically whether there are any concerns that costs will be transferred elsewhere.

Question 11: What is the risk that other charges or fees will be used to recoup costs?

⁸ www.tpr.gov.uk/exit

Question 12: What actions should the Government consider to mitigate this?

Proposed compliance and enforcement regime for the cap

4.17 This consultation document seeks to clarify the Government's current understanding about who is likely, in practice, to impose exit charges in relation to members of occupational pension schemes. Based on that information, the Government will need to decide on whom to place the duty to comply with the cap. From the evidence gathered by TPR to date it would appear that early exit charges primarily flow from contractual arrangements trustees or managers have entered into. The Government has considered two options based on approaches previously adopted in relation to charges and commission.

4.18 The Occupational Pension Schemes (Charges and Governance) Regulations 2015, which imposed the charge cap in relation to the default arrangements of occupational pension schemes used for automatic enrolment, imposed the duty on trustees or managers of these schemes to ensure that the charge cap was not breached.

4.19 However, the recent amendment to those regulations which prevents member-borne charges from being used to recover the costs of commission payments to advisers (the Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2016) places the primary duty on 'service providers' (which is defined in the regulations with further information provided in guidance⁹) and not the trustees or managers. This is because the commission payment to advisers is made by the service provider and not the trustees or managers. Since the latter are one step removed from the commission arrangement it would be unreasonable to place the duty on them, particularly since it is likely that they may not even be aware of the commission arrangement.

4.20 The 2016 Regulations include a new regulation 11B which imposes some duties on the trustees or managers to give information to the service providers (e.g. to tell them that the scheme is one to which the ban on new commission arrangements applies) in order for the service providers to fulfil their duties but the principal duty is on the service provider and TPR can take enforcement action against the service provider where it acts in breach of that duty.

4.21 The Government currently believes - based on an understanding of how the pensions market operates and the findings from the latest TPR survey - that the situation with exit charges is similar, with 'service providers' generally understood to be the source of the majority of exit charges applied to the accumulated funds of occupational pension scheme members. As such, it would be beneficial that the cap would apply to exit charges under existing as well as any future contracts. The

⁹ Paragraph 14 of the guidance clarified that "In practice, service providers are likely to be a person or firm who provides a bundled administration service(s) to trustees or managers, such as an insurer or master trust provider. It will also include a person or firm who provides unbundled administration service(s) to trustees or managers, such as third-party administrators, including employee benefit consultants." <https://www.gov.uk/government/publications/banning-member-borne-commission-in-automatic-enrolment-pension-schemes>

Government considers it would be most effective to place the primary duty to comply with the early exit charge cap on such service providers and/or trustees or managers, depending on who actually applies the charge in practice. This approach would deal with existing early exit charges irrespective of the source and also provide a firm basis for trustees or managers to renegotiate existing contracts with service providers where necessary. In dealing with future contracts, the Government believes it would be sensible for a new obligation to be placed on scheme trustees or managers to ensure no new arrangements in excess of the cap are entered into.

4.22 Unlike the ban on member borne commission, the cap of exit charges will apply to all occupational pension schemes from which an individual can draw a flexible benefit which, therefore, removes any need for a duty on trustees or managers to notify the service provider if the scheme is a qualifying scheme used for automatic enrolment.

4.23 The Government intends that TPR would be responsible for enforcing the early exit charges cap in relation to occupational pension scheme members. As the existing regulator for occupational pension schemes, TPR already have a range of powers to help them meet their regulatory obligations in relation to compliance and enforcement.

Question 13: 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'?

Question 14: Are there any reasons why these arrangements would not be appropriate?

CHAPTER 5 NEXT STEPS

When will the cap take effect

5.1 In January 2016, the Government announced that it would give the FCA a duty to cap early exit charges for members of personal pension schemes, and that requirements would be introduced in relation to occupational pension scheme members to ensure that these charges do not create a barrier to consumers who want to access their pension savings flexibly.

5.2 The Government is aware that, since January, some pension providers have voluntarily capped the exit charges that their customers would be required to pay if they decided to leave their pension scheme early. The Government welcomes these efforts but remains of the view that a legislative cap is required in order to ensure that all individuals who are eligible to access the freedoms, can do so without facing financial barriers.

5.3 The Government will legislate to cap the charges that occupational pension schemes and third parties can charge, and the intention is that this will be implemented in 2017, once the relevant primary and secondary regulatory changes have been made. The Government will seek to legislate in relation to the necessary changes to primary legislation in the forthcoming Pensions Bill. This will include:

- amending existing primary powers to enable the DWP to cap early exit charges for members affected by new and existing contracts;
- consulting and making new regulations to deliver the early exit charges cap for members of occupational pension schemes. The content of these regulations will be informed by the responses to this consultation.

5.4 In addition, the Government will make regulations on exclusions from the FCA charge cap in line with the definition set out in Chapter 3.

SUMMARY OF QUESTIONS

Question 1: Is there any reason why the government should not adopt this approach in relation to occupational pension schemes.

Question 2: 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.

Question 3: Is there any reason why such a definition of early exit charges would not be suitable in relation to occupational pension schemes?

Question 4: 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 likely impact on scheme trustees or managers and third parties who administer occupational pension schemes of imposing the proposed cap?

Question 5: 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?

Question 6: Would a similar definition of MVAs assist trustees or managers to determine what was in scope of an exit charge?

Question 7: Do you have any comments about the proposed approach to “terminal bonuses” and their exclusion from the definition of MVAs?

Question 8: 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?

Question 9: Is there any evidence to suggest that occupational pension schemes should apply a different level of cap to that applied to personal pension schemes?

Question 10: Do you agree with the levels of proposed cap?

Question 11: What is the risk that other charges or fees will be used to recoup costs?

Question 12: What actions should the Government consider to mitigate this?

Question 13: 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"?

Question 14: Are there any reasons why these arrangements would not be appropriate?

How we consult

Consultation principles

This consultation is being conducted in line with the revised Cabinet Office consultation principles published in January 2016. These principles give clear guidance to Government departments on conducting consultations.

Feedback on the consultation process

We value your feedback on how well we consult. If you have any comments about the consultation process (as opposed to comments about the issues which are the subject of the consultation), including if you feel that the consultation does not adhere to the values expressed in the consultation principles or that the process could be improved, please address them to:

DWP Consultation Coordinator
2nd Floor
Caxton House
Tothill Street
London
SW1H 9NA

Email: caxtonhouse.legislation@dwp.gsi.gov.uk

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published consultation report.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purposes of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this.

To find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact the Central Freedom of Information Team:
Email: freedom-of-information-request@dwp.gsi.gov.uk

The Central FoI team cannot advise on specific consultation exercises, only on Freedom of Information issues. Read more information about the [Freedom of Information Act](#).