Department for Work & Pensions

Additional analysis of the impact of capping early exit charges for members of occupational pension schemes

Summary of the expected impact of a 1% cap on early exit charges

May 2016

Background

1. In April 2015, the Government introduced pension freedoms enabling individuals aged 55 and over who are members of a defined contribution (DC) pension scheme to access their pension pot as and when they want to (subject to their marginal rate of income tax, typically 20% or 40%), either via their current scheme or by transferring their savings to a scheme that offers flexible access options.

2. Between July and October 2015 HM Treasury ran a consultation to gather stakeholders' and consumers' views on whether early exit charges applied by schemes were preventing consumers from accessing their pension savings flexibly.

3. The Government's consultation concluded that exit charges existed and were presenting significant barriers to those who incurred them, potentially prohibiting individuals from accessing their pension benefits flexibly. Subsequently, the Government signalled its intention to cap early exit charges for members of contract-based schemes by legislating to give the Financial Conduct Authority (FCA) a duty to impose a cap on excessive early exit charges.

4. On 26th May 2016, the Government launched a further consultation on whether the same cap should apply to early exit charges in occupational DC pension schemes. An Impact Assessment was published alongside the consultation, setting out the expected effects of introducing a cap on exit charges. It considered a range of levels of cap from 2-10%. This analysis supplements the analysis included in the Impact Assessment, by exploring the impact of a 1% cap on exit charges.

5. For more information on the proposed cap on exit charges, see the Impact Assessment and consultation available at: https://www.gov.uk/government/consultations/capping-early-exit-charges-for-members-of-occupational-pension-schemes

Analysis

6. A cap on exit charges, whether as a percentage or cash amount paid, would benefit affected members who wish to withdraw their pension funds or seek to move them between pension funds by reducing the charges paid and removing a potential barrier from being able to access the freedoms.

7. Pension schemes (or their third-party providers) that currently charge an exit fee above the level of the cap will face a loss of revenue. The costs to business from charges foregone are calculated as the difference between the total amount of exit charges currently paid with and without a cap. Assuming schemes do not attempt to recoup this revenue by other means, there would be an equal and opposite benefit to members[1].

8. There would also be some administrative costs to pension schemes and administrators from familiarisation with the new rules, which will occur regardless of the level of the cap, and implementation of the cap.

Estimated impact of a 1% cap

9. We estimate that the impact of imposing a cap on exit charges at 1% of funds under management would be as shown in Table 1. All figures are in 2015 constant price terms and in £m.

Table 1: Estimated impact of a 1% cap on early exit charges

Costs (£m)	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Cost of charges foregone	4.66	0.61	0.61	0.61	0.61	0.61	0.61	0.61	0.61	0.61
Implementation Costs	0.42	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05	0.05
Familiarisation Costs	0.28	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total costs	5.37	0.66	0.66	0.66	0.66	0.66	0.66	0.66	0.66	0.66

Benefits (£m)	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026
Benefits to members	4.66	0.61	0.61	0.61	0.61	0.61	0.61	0.61	0.61	0.61

10. Further detail is set out below. This analysis uses the same approach as the Impact Assessment and the results are directly comparable. For a full explanation

[1] This is a simplifying assumption that is likely to over-state the cost to business (and therefore the benefit to scheme members) since we might expect some schemes to attempt to recover revenue lost as a result of the cap, but currently have no evidence that would allow us to reliably estimate the impact.

of the methodology and data used to estimate the impact of capping exit charges, please see the Impact Assessment available at https://www.gov.uk/government/consultations/capping-early-exit-charges-for-members-of-occupational-pension-schemes.

Cost of charges foregone

11. There would be costs to occupational pension schemes, providers and administrators as a result of lower revenue from charges foregone, estimated at £4.66m in the first year and £0.61m in each subsequent year. This is calculated following the same approach used in the Impact Assessment.

    i. We use data from a survey conducted by the Pensions Regulator (TPR) on the prevalence of exit charges in occupational pension schemes to estimate the total number of members who would currently face an early exit charge if they wished to leave their scheme early. We then assume that 20% of those will choose to leave early in the first year that a cap is applied. This gives an estimate of around 8,500 individuals who will potentially benefit from a cap in the first year.

    ii. Table 2 shows the estimated distribution of charges currently faced by those wishing to access their pension flexibly. The distribution of exit charges applied is based on data collected by the FCA in respect of personal pension policies. It shows that where a percentage charge is applied, 64% of pots face a charge above 1%. Applying this proportion to the 8,500 members of occupational pension schemes potentially affected, gives around 5,400 individuals who would benefit from a 1% cap in the first year.

    iii. Table 3 shows the estimated distribution of charges if a 1% cap were applied. Comparing the total revenue from exit charges with and without a 1% cap leaves a difference of £4.66 million. This represents the charges that would be foregone by schemes and providers if a 1% cap were introduced.

    iv. In subsequent years, it is assumed that the number of individuals wishing to access their pot would be 13% of the volumes from the first year. This is based on an assumption that in each year after the first year of the policy's implementation, the only people who would access their pensions early would be those reaching age 55 in that year. ONS population projections show that the number of adults in the UK aged 54 is 13% of the number of adults aged 55 to State Pension age. This means the costs to providers in subsequent years would be £0.61 million.

Table 2: Estimated distribution of exit charges faced by occupational pension scheme members choosing to access their pensions flexibly, with no cap			
Charge %	Mean exit charge in this band (A)	Number of pots accessed (B)	Estimated total value of exit charges paid (A x B)
0-1	£83.80	3,067	£257,013
1-2	£251.41	1,464	£368,069
2-3	£419.01	896	£375,472
3-4	£586.62	682	£399,799
4-5	£754.22	505	£380,761
5-6	£921.83	442	£407,202
6-7	£1,089.43	177	£192,496
7-8	£1,257.04	151	£190,380
8-9	£1,424.64	126	£179,804
9-10	£1,592.25	114	£180,861
10-15	£2,095.06	328	£687,484
15-20	£2,933.09	240	£703,349
20-40	£5,028.15	215	£1,078,822
40+	£8,380.24	50	£423,067
Total		8,456	£5,824,580

Table 3: Estimated distribution of charges in the first year after 1% exit charge cap were applied			
Charge %	Mean exit charge in this band with a 1% cap (A*)	Number of pots (B)	Estimated total value of exit charges paid (A* x B)
0-1	£83.80	3,067	£257,013
1-2	£167.60	1,464	£245,379
2-3	£167.60	896	£150,189
3-4	£167.60	682	£114,228
4-5	£167.60	505	£84,613
5-6	£167.60	442	£74,037
6-7	£167.60	177	£29,615
7-8	£167.60	151	£25,384
8-9	£167.60	126	£21,153
9-10	£167.60	114	£19,038
10-15	£167.60	328	£54,999
15-20	£167.60	240	£40,191
20-40	£167.60	215	£35,961
40+	£167.60	50	£8,461
Total		8,456	£1,160,262

Implementation costs

12. There would be on-going administrative costs to schemes, providers or administrators from overriding existing charges each time a member exited the scheme early and the cap applied. In total these are estimated at £0.42m in the first year and £0.06m in each subsequent year:

    i. This is based on an assumption of 4 hours of a pension administrator's time for every customer that is affected by the cap, to verify that the exit charge has breached the cap. With a wage assumption of £19.10 per hour (including non-wage costs)[2], this gives a unit cost of £76.40 per override in 2014/15 prices.

Table 4: Estimated implementation costs in first and subsequent years				
Level of cap	Customers benefiting in the first year	Costs to industry in the first year (£m)	Customers benefiting in each subsequent year	Annual costs after the first year (£m)
1%	5,390	£0.42	700	£0.05

Familiarisation costs

13. There would also be one-off familiarisation costs to schemes, providers or administrators to understand the scope of the cap, and where applicable, design a method for overriding the cap on a case by case basis. These are estimated at £0.28m in 2017:

    i. For schemes which do not have exit charges, familiarisation with the new rules is assumed to take around 1 hour for a professional with a wage level of £24.77 (including non-wage costs)[3] giving a unit cost of around £24.77 (2014/15 prices). We assume that 96% of trust-based unbundled[4] DC and dual-section hybrid schemes do not have exit charges (based on TPR data).

    ii. For schemes that have exit charges and for the administrators and insurers that service schemes with exit charges, we assume it takes the compliance officer at each affected business 24 hours at an hourly wage level of £24.77 (including non-wage costs) to complete the familiarisation. In addition, it is assumed that 10 operational staff with an hourly wage of £19.10 will take 2 hours each to complete the training. This gives a total

[2] The estimate of £19.10 is based on the gross median hourly rate for an associate professional from the Annual Survey of Hours and Earnings 2015, which has then been increased by 27% to account for non-wage costs.

[3] The estimate of £24.77 is based on the gross median hourly rate for a professional from the Annual Survey of Hours and Earnings 2015, increased by 27% to account for non-wage costs.

[4] Unbundled schemes are those which have been created by employers rather than bundled which have been purchased from a pension provider and have a single company providing all services.

unit cost of £976 per business in 2014/15 prices. TPR has previously advised that just over 200 unique insurers, administrators, and Master Trusts provide services to the vast majority of DC schemes; we assume that all of these will have exit charges, along with the remaining 4% of unbundled and dual-section hybrid schemes.

Table 5: Estimated familiarisation costs in first year		
	Where exit charges do not apply	Where exit charges apply
Number of schemes, insurers and administrators affected	1,092	253
Cost per business	£24.77	£976
Total cost (£m)	£0.03	£0.25

Benefits to consumers

14. There would be benefits to members of trust-based occupational pension schemes where exit charges currently exceed the level of the cap. These benefits are assumed to be equal to the costs to businesses from the charges foregone, at £4.66m in the first year and £0.61m in each subsequent year.

Contact

Issued by:

Private Pensions and Stewardship Analysis Division
Department for Work and Pensions

For analytical queries about the content of this document, please contact Eleanor Pierce (Eleanor.Pierce@dwp.gsi.gov.uk)

Press enquiries should be directed to the Department for Work and Pensions press office:

Media Enquiries: 0203 267 5129
Out of hours: 0203 267 5144
Website: https://www.gov.uk/
Follow us on Twitter: www.twitter.com/dwppressoffice