# Capping early exit charges for members of occupational pension schemes

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## Introduction

On 26 May 2016, the DWP published a consultation on capping early exit charges for members of occupational pension schemes ("the Consultation") that contain "flexible benefits".

With the aim of ensuring that all consumers benefit from the cap, regardless of the type of pension scheme they have saved into, comparable proposals have been published by the FCA in respect of personal pension schemes.

## Key points

- With effect from 2017, the Government intends to introduce a cap on early exit charges imposed by trustees, managers and / or providers of occupational and personal pension schemes when a member leaves the scheme early in order to access their benefits flexibly.
- The cap is not intended to prevent early exit charges being levied in existing schemes; rather the legislation will aim to ensure that consumers wishing to access their pension savings flexibly have an appropriate degree of protection.
- Mirroring the FCA's proposals in the contract based sphere, the Consultation suggests a cap of 1% for existing occupational pension schemes and 0% for new occupational pension schemes.
- If there is evidence that pension schemes are increasing costs elsewhere to compensate for the loss of exit charges, the Government will consider whether action is necessary to ensure members are protected.

## Background

The Government wants to ensure that individuals can access the retirement flexibilities "easily, and at reasonable cost". In its July 2015 consultation (see our Alert), it set out to gather evidence and explore ways to strengthen people's rights to access their flexible benefits (broadly cash balance and money purchase benefits), and remove any "unjustifiable" barriers to their doing so. This involved an examination of, whether excessive early exit penalties were being levied, the transfer process and the circumstances in which someone should seek financial advice.

The consultation found that, whilst the majority of eligible individuals are able to access their benefits under the new freedoms, there was a "small but significant" number who had been effectively prevented from doing so because of high exit charges or long transfer times.

As a result, on 19 January 2016, Chancellor George Osborne announced that the Government would introduce legislation to limit early exit charges for people seeking to access the freedoms, by placing a new duty on the FCA to cap such charges.

# Definition of early exit charges

The Bank of England and Financial Services Act 2016 defines an "early exit charge", in relation to a member of a pension scheme, as a charge which:

a. is imposed under the scheme when a member who has reached normal minimum pension age takes their benefits under the scheme, converts their scheme benefits into different benefits or transfers their benefits to another pension scheme

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

Depending on the outcome of the Consultation, the Government is minded to adopt this definition in relation to the exit charge cap.

**Exclusions**

Market Value Adjustments ("MVAs", also known as Market Value Reductions) are generally found in "with profits" or similar 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 benefits on exiting their pension scheme early in order to ensure that the surrender value attributed to those benefits more closely aligns to the actual market value at that point.

As the aim of an MVA is to return an individual to their "share" of the pension scheme at the point of exit and, where applied properly, they are applied on a consistent basis to all scheme members, they will not be within the scope of the cap.

Regulations will make clear that adjustments made to the value of the benefits 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 classified as MVAs.

# Source of early exit charges

Evidence indicates that occupational pension schemes which are administered by third parties are more likely to apply an early exit charge. Exit charges can be imposed either directly by the scheme trustees or as a consequence of contractual arrangements they have entered into with a third party. The cap will apply to both types of charge.

In the Consultation, the Government requests input on whether there are other costs or charges in occupational schemes which might constitute exit charges and, if so, whether such charges are applied equally to all scheme members.

## Compliance and enforcement

The primary duty to comply with the early exit charge cap will be placed upon the party who actually applies the charge in practice.  This could be a service provider or the trustees of an occupational pension scheme. The Government considers that this will provide a firm basis for trustees to renegotiate existing contracts with service providers where necessary.  In respect of future contracts, trustees should ensure that no new arrangements in excess of the cap are entered into.

TPR will be responsible for enforcement.

## Next steps

The Consultation closes on 16 August 2016.

Legislation to implement the cap will be set out in the forthcoming Pensions Bill and new regulations.  It is intended to come into force in 2017.

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