Capping early exit charges: Government response

Alert | 16 November 2016

Introduction

On 15 November 2016, the Government issued its response to the DWP's May 2016 consultation ("the Consultation") on capping early exit charges for members of occupational pension schemes that contain "flexible benefits" (broadly speaking, DC benefits).

The Consultation was run in parallel with proposals published by the FCA in respect of personal pension schemes, with the aim of ensuring that all consumers benefit from the cap, regardless of the type of pension scheme they have saved into.

Key points

- The Government notes that "the overwhelming response [to the Consultation] was that there were no reasons why occupational pension schemes should be treated differently" from personal and stakeholder schemes in terms of a cap.
- With effect from October 2017, the Government will therefore 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 will be 1% for existing members of occupational pension schemes, and 0% for new members, to align with the FCA's approach in relation to contract based pensions.
- The legislation will be introduced via the Pension Schemes Bill, amending and adding to the existing powers in the Pensions Act 2014. The Government intends to consult publicly on the draft regulations in early 2017.

Background

With effect from 6 April 2015, individuals with flexible benefits were given greater freedom and choice over how to access their retirement savings.

The Government wants to ensure that individuals can access the retirement flexibilities (or "pension freedoms") "easily, and at reasonable cost". In its July 2015 consultation (see our Alert), whilst the majority of eligible individuals were able to access their benefits under the pension freedoms, the Government found that 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, the Government announced that it would introduce legislation to limit early exit charges for people seeking to access the pension freedoms, by placing a new duty on the FCA to cap such charges in contract based schemes.

The FCA announced on 15 November 2016 that it intends to bring its capping rules into force with effect from 31 March 2017.

Definition of early exit charges

The cap on early exit charges will generally apply to “all charges imposed on members (who are eligible to access their pension savings flexibly) when seeking to access their pension early, which they would not face if they carried out the same transaction at their pension age.” The Government is therefore “only concerned with capping early exit charges for those aged between 55 and their pension age”.

Given the difference in underlying primary legislation between personal and stakeholder pension schemes on the one hand, and occupational pension schemes on the other, it is likely that the definition of early exit charges will look different across the two sets of legislation. However, it is intended that it will have the same impact.

Exclusions

The response confirms that Market Value Adjustments (“MVAs”, also known as Market Value Reductions) are not within the scope of the cap. The intention is that the 1% cap will apply to the value of the member’s pension pot after any MVA has been applied.

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 also out of scope of the cap. Likewise, any charges associated with accessing a decumulation option (such a as drawdown) are not included in the cap as they would be incurred whether the member was accessing the product at their pension age or earlier.

However, any other exit charges “derived from occupational pension scheme investments in “with-profits funds” will still be captured by … the cap.”

Level of the cap

The date a member joins a scheme will be the key criteria for determining whether the 1% cap or total ban on early exit charges applies. In practice, this will mean that:

- schemes which currently impose early exit charges on members wishing to access the pension freedoms will have to offer different charging structures or terms to new members joining the scheme
- where an existing scheme member decides to increase their contributions after the regulations come into effect, the additional contributions will still be subject to the 1% cap.

The response also states that the Government intends to legislate to ensure that, in circumstances where more than one party applies a charge, the member is not charged more than 1% of the value of their pot in total.

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 or managers of an occupational pension scheme.

The Government intends to legislate to ensure that the charge cannot be increased in circumstances where either an existing contract between the trustees or managers of the scheme and the service provider, or the scheme rules themselves, specify an early exit charge which is currently below 1%.

TPR will be responsible for enforcement, regulating compliance with the cap in line with its published "DC compliance and enforcement policy". This will include activities to support trustees and their advisers to comply with their legal obligations.

Next steps

Legislation supporting the implementation of the cap is set out in the Pension Schemes Bill, which was published on 20 October 2016. Regulations setting out the detail will follow in the New Year.

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