Capping early exit charges for members of occupational schemes
Response by TISA to DWP Consultation

Date 16 August 2016

About TISA

TISA is a not-for-profit membership association operating within the financial services industry. The focus of our recommendations and actions is improved outcomes for consumers and UK plc with this approach leading to a stronger UK financial services industry.

TISA's growing membership comprises over 150 firms involved in the supply and distribution of savings and investment products and services. These members represent many different sectors of the financial services industry, including asset managers, insurance companies, fund managers, distributors, building societies, investment managers, third party administrators, consultants and advisers, software providers, financial advisers, pension providers, banks and stockbrokers.

TISA has a successful track record in working cooperatively with government, regulators, HMT, DWP and HMRC to improve the performance of the industry and the outcomes for the public. Effective policy and regulation and the creation of efficient industry infrastructure continues to be the major focus for our members. TISA is unique in that it represents the entire financial services industry, incorporating cross-sector policy, industry and technical expertise. Whilst we maintain a solid partnership with government, the regulators and wider industry, we remain independent and develop neutral views and opinions. This impartiality is reflected in our ability to drive development projects which improve industry performance and consumer outcomes, putting us in the unique position of being able to constantly challenge the status quo to bring about material improvement.

Summary of Recommendations

TISA is a strong supporter of the pension freedoms, we believe the instinct to trust members to make the best decisions is a good one and are enthusiastic about working with all interested parties to ensure that the reforms work for customers, the industry and the wider national interest.

We believe that pension early exit charges are in the main a throwback to Insurance contract designs predicated on the illusion of retrieving up front commissions slowly over the term of the contract when in reality they had been paid out immediately and could not be recouped from the distributor after the first two years. We also concur with the research that this type of charge has not featured in contracts sold by the mainstream providers over the last 20 – 25 years so the population with any contract impacted is declining rapidly through natural maturity.

For these reasons we believe setting the cap at 1% will have little resonance with scheme members impacted as they had little understanding of the charges mechanisms in the first place and would see any percentage charge as arbitrary, at best.

We note in the findings of the FCA evidence gathering a seemingly strong drop in the resistance to exit charges once the charge drops to 1% or less but given the data is presented in bands we wonder whether more granular breakdown might be helpful to understand if the customer resistance threshold is actually closer to 0% than 1% and if their understanding of the charge would be better served by expressing the charge cap as a fixed amount.

We concur that is desirable that occupational schemes and personal pensions/stakeholder schemes have equivalent rules on exit charges and that care should be taken defining rules on with-profits MVA's and responsibilities of service providers to avoid unintended complexities.

Consultation Response

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?

We believe it is vital that there is consistency between personal/stakeholder and occupational pensions and welcome the consultation by the department. The rules as proposed do throw up the oddity that once over 55 a policyholder can transfer to a new provider with a capped penalty whether or not they are taking benefits, whereas the 54 year old will still suffer an uncapped deduction. We noted in the FCA paper their comment about potentially returning to this issue later and think this would have merit given customers just the wrong side of this line will feel aggrieved. We would encourage the DWP to consider this further as well. We didn't note anything in the paper concerning benefits paid out pre minimum retirement age, for example in the case of ill health pensions and serious ill health lump sums, we would expect these benefit payments to be included in the scope of these proposals.

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?

We welcome the initiative to cap these charges, we believe that they are mainly a throwback to product designs in Insurance contracts which were often used to backed occupational schemes such as Executive Pensions and smaller Defined Contribution Workplace schemes. In these schemes typically the Trustees managed no assets other than the monies invested in the Insurance contract so any charges levied on the individual members fund was passed straight through to that scheme member.

These designs were predicated on the illusion of retrieving up front commissions slowly over the term of the contract when in reality they had been paid out immediately and could not be recouped from the distributor after the first two years, hence the need to go back to the members pension pot to reduce the value in the event of an early exit. The charges were usually based on a formula such as 'x% of the fund for each year prior to the selected retirement age' and hence decline the closer the member gets to that target age. We also believe that this type of charge has not featured in products sold by the mainstream Insurers over the last 20 – 25 years so the population with any product impacted is declining rapidly through natural maturity.

The other 'early exit charges' Trustees may ask members to meet are likely to be processing charges passed on by third party administrators for benefit or transfer payments, these are likely to be fixed amounts typically in the range £50 – 75, we do not believe this type of charge is unreasonable.

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?

We agree that in principle MVA's are not an early exit charge although historic poor communication of the way with-profits bonus mechanisms work and insufficient management of expectations have previously led many scheme members to think of bonus allocations as irreversible entitlements. FSA initiatives had done much to improve practice and communications of with-profits allocations and terms and we would expect this good practice to be carried over into occupational schemes.

Used properly MVA's should adjust the total return a member has been allocated (including terminal bonuses) to closer reflect the return on the fund underlying assets to protect remaining with-profits policyholders funds at times when asset values are below bonus values. We are aware that there

are many with-profits bonus designs and Insurers have used different methods of bonus allocation and valuation. This has led to differences in the way 'terminal bonuses' are treated and we would be wary of creating a rule that had the effect of distorting the with-profits fund's solvency by protecting terminal bonuses from MVA adjustments without further consideration of the impacts. Due to the sensitivity of the actual words that go into statute we suggest that the department undertakes discussions on the exact drafting with interested parties.

We concur that it would be desirable for the treatment of with-profits policies in occupational schemes to be comparable to that for personal pensions and support that aim.

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?

We noted in the FCA consultation paper they acknowledge the limitations of the scale of data collected and timeframe studied. The data collected on occupational schemes appears to be even more limited and we believe warrants further investigation. We think a more granular analysis of customer resistance to charges in the 0% - 1% band would be beneficial given the apparent change in attitude around this level, we have a suspicion that the threshold may be closer to 0% than 1%. We note in the Pensions Freedoms data collection exercise: analysis and findings September 2015 it is stated that 91% of deductions are under £100 (although it is not clear whether this includes those that are zero), and the TPR data collected showed an average of under £200, reinforcing our view that more work here might be beneficial.

We note that in modern personal pension contract terms there is no exit charge and providers often charge fixed administration fees for setting up benefits. In a quick survey of five leading SIPP providers that charge explicit fees we noted that these charges are in the £50 - £150 range, a raw average of £75. The September 2015 Pensions Freedoms data collection exercise paper states these charges reasonably accurately reflect the operational cost of setting up benefits. Intuitively we believe that customers find it reasonable that there is a fixed charge for undertaking transactions and we would encourage customer testing of a simple fixed charge as an alternative approach.

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?

We note that the cap is proposed as a broad brush calculation on the value of the policy at point of taking benefits (or transferring). We are aware that many policies were sub divided into segments (to facilitate staggered retirement vesting) and that up front commissions were not normally paid on transfers in and contracted out protected rights contributions. The practice of charge allocation and issue of multiple policies varies greatly across the industry.

We would recommend some guidance notes to stress that benefits arising from a policy (or policy cluster) taken out by the Trustees that did not bear up front commissions cannot be subject to early exit charges (to compensate for the capping of the element that has got exit charges).

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?

We agree that in practice most early exit charges are likely to be levied by contractual arrangements in place with Insurers or Mastertrusts where commission has been paid to advisers and/or introducers but care should be taken over the 'catch all' term of 'service providers'

We are aware that some third party administrators may also charge transaction fees for processing benefit payments and these can sometimes be charged to the member rather than being paid by the sponsoring employer. We believe that such processing charges that reflect the true and fair cost of the administration are reasonable and should be allowable.

We think that ultimately it should be the responsibility of the Trustees to ensure the cap is adhered to by managing its third party contracts in compliance with the regulations. Other service providers (Insurers and Mastertrusts in the main) that have exit charges in their contracts related to previous initial commission payments should be required to reduce those charges to the level of the cap.