Response by TISA to CP16/15
Capping early exit pension charges

18 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 concur that pension early exit charges are in the main a throwback to product 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, hence the need to go back to the members pension pot to reduce the value in the event of an early exit. We also concur that this type of charge has not featured in products sold by the mainstream providers over the last 20 – 25 years so the population with any product impacted is declining rapidly through natural maturity.

For these reasons we believe setting the cap at 1% will have little resonance with customers 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 your 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 strongly believe that the Government should take this opportunity to have a consistent policy on the rules for exit charges on Lifetime ISA and Pensions to ensure the needless arbitrage between the retirement savings vehicles is avoided.

Consultation responses

Q1: Do you have any comments about the impact of our proposals on equality and diversity?

The proposals 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 note your 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 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.

Q2: Do you agree with our methodology?

We believe this to be a reasonable approach and you acknowledge the limitations of the scale of data collected and timeframe studied. 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) reinforcing our view that more work here might be beneficial.

Q3: Do you agree that a cap of 1% on early exit charges in existing pension contracts is appropriate? If not, do you consider that a cap at a different level, or applied in a different manner, would be more appropriate (and, if so, why)?

We welcome the initiative to cap these charges, we concur that they are mainly a throwback to product 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, hence the need to go back to the members pension pot to reduce the value in the event of an early exit. We also concur that this type of charge has not featured in products sold by the mainstream providers over the last 20 – 25 years so the population with any product impacted is declining rapidly through natural maturity.

We note that in modern 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.

Q4: Do you agree that a cap of 0% on early exit charges in new pension contracts is appropriate? If not, do you consider that a cap at a different level, or applied in a different manner, would be more appropriate (and, if so, why)?

We support this proposal.

Q5: Would our proposals have any other implications on pension providers or on consumers that we have not considered in our analysis?

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 within a policy (or policy cluster) 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).

Q6: Do you agree that we have identified all the relevant costs and benefits?

No further additions.

Q7: Do you think the benefits to consumers, or the costs to firms, should be assessed in some other way (and, if so, how)?

No comments.

Q8: Do you have any comments on the data we have used in completing our cost benefit analysis?

We believe it is a reasonable approach and you acknowledge the limitations of the scale and timeframe the data was collected over. For these reasons we suggest further analysis could be beneficial.

Q9: Do you think our analysis considers an appropriate range of cap levels?

We note that over 70% of customers who were subject to an exit charge felt that the explanation of the charge was poor (HMT response document February 2016). We do believe this is a significant

finding when combined with the apparent change in customer behaviour when the charge falls below 1% and warrants further investigation. This research should be focussed on establishing if customer's behaviour is affected by the percentage level or by the actual monetary amount. The results of this research would also be very informative to the policy proposal for an exit charge over and above the incentives granted on Lifetime ISA.

Q10: Do you have any comments on our analysis of the data?

We note that no correlation analysis was possible on percentage charges and monetary values in the data collected on potential early exit charges in the September 2015 data collection document, we believe this analysis would be helpful in understanding the customer behaviour.

Q11: Do you consider we have omitted any significant points or issues?

No comments.