

The Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2017

Government response to the consultation on these draft regulations

July 2017

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1 Introduction

1.1 This paper forms the Government's response to a consultation on the draft Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2017 ("the draft regulations"), which ran from the 5 April 2017 to 31 May 2017. The draft regulations were designed to:

- introduce restrictions on early exit charges for members of occupational pension schemes who are eligible to access the pension freedoms; and
- restrict charges being imposed on members of certain occupational pension schemes to recoup the costs of commission payments made to advisers in relation to contracts entered into before 6 April 2016.

1.2 In summary, the draft regulations are intended to introduce a 1% cap on early exit charges in relation to existing members of occupational pension schemes (i.e. those who were members of these schemes before the regulations come into force on 1 October 2017) and ban early exit charges in relation to members who joined these schemes after the regulations comes into force.

1.3 The draft regulations also prohibit charges being imposed on members of occupational pension schemes used for automatic enrolment to recoup the cost of commission payments made to advisers after the 1 October 2017 and in relation to agreements entered into before the 6 April 2016.

Restricting early exit charges

1.4 The pension freedoms give individuals aged 55 and over greater choice about how and when they access their pension savings. As a result, the pension freedoms have increased the attractiveness for individuals with non-flexible benefits of transferring or converting these benefits into a form which can be accessed flexibly.

1.5 However, the Government became aware that individuals were facing a range of potential barriers when seeking to access their savings under the pension freedoms. This included incurring early exit charges which can act as a barrier to some people seeking to access their pension savings.

- 1.6 To address this issue the Government, along with the Financial Conduct Authority (FCA), carried out public consultations to establish the extent of the problem across both personal and occupational pensions.
- 1.7. For personal and stakeholder pensions the Financial Services and Markets Act 2000 was amended to give the FCA a duty to make rules to ban or cap early exit charges in personal and stakeholder pension schemes. The FCA Pension Schemes (Restrictions on Early Exit Charges) Instrument 2016 (FCA2016/72) imposes, from 31 March 2017, restrictions on early exit charges in personal and stakeholder pension schemes – a 1% cap on the value of the member’s benefits being taken, converted or transferred for individuals who were members personal and stakeholder pension schemes on that date and a ban on such charges for new members of personal and stakeholder pensions.
- 1.8 In November 2016, in response to its consultation paper *“Capping early exit charges for members of occupational pension schemes - ensuring a fair and consistent approach across all defined contributions”* the Government set out its intention to introduce regulations to set a cap on early exit charges in line with that proposed by the FCA.

Existing member-borne commission ban

- 1.9 In March 2014, the Government announced that from April 2016 no scheme used for automatic enrolment should contain member-borne commission payments to advisers. This followed a recommendation by the Office of Fair Trading (OFT) in 2013 that schemes with commission built into them should not be used for automatic enrolment. The OFT found that some members were unaware they were paying commission and that commission was a barrier to switching (e.g. advisers were unlikely to want to lose a commission income stream by recommending a switch to another pension scheme that didn’t contain commission but may have offered better value for money for members).
- 1.10 In its January 2016 response to the October 2015 consultation *“Better workplace pensions: Banning member-borne commission payments in occupational pension schemes”*, the Government announced it would be taking a phased approach to the member-borne commission ban. This was because the complexity involved in making legislation to ban existing member-borne commission meant it was unlikely that they would be ready to come into force in

April 2016.

- 1.11 The Government implemented the first phase of the ban by introducing regulations on 6 April 2016 (the Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2016). The regulations prohibited charges being imposed on members of certain occupational pension schemes for the purposes of recouping commission payments made to advisers. The regulations applied to arrangements between the trustees or managers and the service provider that were entered into on or after the 6 April 2016. The FCA banned commission in workplace personal pension schemes from 6 April 2016.
- 1.12 These draft regulations are intended to implement the second phase of the member-borne commission ban. The draft regulations prohibit charges being imposed on members of certain occupational pension schemes to recoup the cost of commission payments made to advisers. The draft regulations apply to agreements entered into before 6 April 2016 (and which were not renewed or varied after that date). The prohibition in the draft regulations will not apply if the payment to the adviser was made before the date the draft regulations come into force (1st October 2017). In line with the approach taken by FCA with its commission ban, the draft regulations do not prohibit service providers from imposing member-borne commission charges for the purpose of recovering initial commission. This will ensure a consistent approach to the member-borne commission ban across workplace pensions.
- 1.13 The draft regulations also allow service providers up to six months to make any changes or modifications to their systems processes in order to comply with the prohibition. Following consultation and engagement with stakeholders, the Government determined that six months provided sufficient time to make any required changes. This means that although the draft regulations will come into force on 1 October 2017, the prohibition will not apply until 1 April 2018 i.e. after the six month period has expired.

2 The draft regulations

- 2.1 The draft regulations took into account responses to previous consultations relating to the treatment of members of occupational pension schemes (Annex 2 contains details of these consultations). Stakeholder views were also sought on whether these draft regulations would work in practice to achieve the policy

intent of capping or banning early exit charges and banning existing member-borne commission in occupational pension schemes.

2.2 The consultation asked the following questions :

Q. Do you have any comments on how the draft regulations meet the Government's policy objectives on capping early exit charges and banning existing member-borne commission charges?

Q. Are you aware of any situation where an early exit charge is imposed on a member by more than one service provider in relation to a single scheme?

Q. If more than one service provider imposes an early exit charge on a member in relation to a single scheme what can a trustee or manager of that scheme do to ensure the combined value of the charges is less than 1% of the value of the member's benefits being taken, converted or transferred?

Q. Do you have any comments on the content of the draft regulations?

2.3 These questions formed the basis of the responses.

3. Responses to the consultation

3.1 A total of 12 formal responses were received to the consultation which have been considered carefully. The Government is grateful to everyone who replied. A list of respondents is at annex 1.

3.2 Overall, the responses agreed the draft regulations met their intended purpose. The queries raised primarily related to drafting and minor technical points and a request for more clarification on some aspects of the regulations. For example, some respondents felt it would be helpful to have clarity on "definition of normal pension age", "relevant contract" and "relevant scheme". After carefully considering these points, the draft regulations have been amended where appropriate. An outline of the more substantive queries received is provided below.

Member-borne commission charges

3.3 In the main, the substantive queries relate to the relevant date of the prohibition and the amount of time given to service providers to comply with the existing member-borne commission ban. Another relates to the expectation the Government has that member-borne charge levels would reduce following the removal of existing member-borne commission arrangements. In summary, respondents raised the following issues:

- A. The draft regulations state the relevant date for prohibition starts to apply in relation to pre 6 April 2016 contracts with commission payments stopped after 1 October 2017. In the majority of cases the relevant date from which the commission is banned would be 1 April 2018.
- B. New regulation 11B (2B) would appear to have the effect that the new ban cannot apply to any service provider under a pre-6 April 2016 agreement until (at the earliest) the expiry of a 6 month period from 1 October 2017 (not until 1 April 2018). It is unclear why there is the inclusion of the 6 month transitional period for compliance by the service provider when a 1 month period was considered sufficient when the ban of new member-borne commission arrangements was introduced on 6 April 2016.
- C. Uncertainty over how service providers would deliver commensurate reductions in member-borne charges following the removal of existing member-borne arrangements.

Government response

3.4 The Government thanks respondents for raising these queries and, after considering the points raised, has made some changes to the draft regulations that, for example, intend to improve their clarity. The draft regulations will apply to agreements between trustees or managers and service providers of certain occupational pension schemes that were entered into before the 6 April 2016 (and which were not varied or renewed after that date). The draft regulations will prohibit service providers from imposing charges on members of these schemes in order to recoup commission payments made to advisers after the

draft regulations come into force on 1 October 2017.

- 3.5 The following paragraphs provide a response to queries A and B in paragraph 3.3. They explain the rationale behind the time periods the Government has given service providers to comply with the existing member-borne commission ban.
- 3.6 During the Government's October 2015 consultation and engagement with industry stakeholders, it became apparent that the complexity of removing existing commission arrangements meant that service providers may need time to make changes to their systems and processes in order to comply with the ban. The amount of time that pension providers initially suggested would be needed ranged from 3 months to 18 months. Given that industry has been aware for some time that the ban was going to be implemented, the Government considered six months to be sufficient time in which to make these changes. Most of the providers we engaged with on this issue agreed.
- 3.7 The Government agrees with some respondents that the original provisions in the draft regulations inadvertently resulted in service providers being given a much longer period than six months. Regulation 8 of the consultation draft (regulation 9 in the revised draft), which amends regulation 11B of the Occupational Pension Schemes (Charges and Governance) Regulations 2015 ("the 2015 Regulations") has, therefore, been modified to make clear that service providers will only be granted up to six months to comply with the prohibition that takes effect on 1 April 2018. A longer period, set out in regulation 11B(5) of the 2015 Regulations will only be allowed where the service provider needs to request more information from the trustees or managers about former workers in order for them to comply. The draft regulations have also been amended to make clear that service providers must confirm in writing to the trustees or managers of the specified scheme, within 1 month beginning 1 April 2018, that they are complying with the prohibition that takes effect on this date¹.
- 3.8 As set out in part C of paragraph 3.3, some respondents indicated they were unsure how they were expected to deliver commensurate reductions in charges after the prohibition took effect. The Government stated in the consultation document that it wanted members to benefit from the prohibition and that it

¹ Regulation 9(5) of the revised draft regulations inserts regulation 11B(3A) into the 2015 Regulations.

expected to see a reduction in charge levels following the removal of existing member-borne commission arrangements. The Government does not want to specify how charge levels should be reduced and is willing to let service providers ensure that members benefit from the existing member-borne commission ban. However, as previously stated, the Government will consider taking further action if it doesn't see members benefitting.

- 3.9 In line with the approach taken by the FCA to its commission ban in workplace personal pension schemes, the draft regulations do not prohibit charges being imposed on members in relation to payments that are made to advisers before the regulations come into force on 1 October 2017. As with the FCA ban, this ensures that service providers who made an initial commission payment to an adviser before the draft regulations come into force will be able to continue to recoup this through member-borne charges. This approach will ensure parity across workplace pension schemes. It should also be noted that the prohibition that takes effect from the 1 April 2018 will apply to any commission payment that is made by a service provider to an adviser after the date the draft regulations come into force, regardless of the type of commission.

Multiple charges

- 3.10 The draft regulations published for consultation covered possible scenarios where the scheme member could be subject to multiple early exit charges. Regulation 13D, inserted by draft regulation 10 of the consultation draft, provided that where multiple early exit charges are imposed on a member of a scheme the duty falls on the trustees and managers of the scheme for ensuring the combined value of the charges do not exceed 1%.
- 3.11 However, the Government is not aware of any scenarios where multiple charges could be imposed on a member of a scheme. To determine whether draft inserted regulation 13D was required the consultation asked a specific question exploring any situations where an early exit charge could be imposed on a member by more than one service provider in relation to a single scheme.

Government response

- 3.12 The consultation responses did not identify any specific cases where multiple charges could apply. One respondent raised a hypothetical scenario where an

adviser could apply a charge related to advice to the employer and then apply charges related to advice to the member. In the light of this regulation 13D has been removed from the insertions made by the draft regulations.

Guidance

- 3.13 The draft regulations also provide for the Secretary of State to issue guidance from time to time on how the value of a member's benefits is to be calculated for the purposes of determining the cap on early exit charges. The intention is to issue guidance on how market value adjustments and terminal bonuses are to be treated at the time the regulations are laid.

4. Conclusion

- 4.1 The Government is grateful to those who responded to this technical consultation on the draft regulations. It is pleased that, overall, respondents considered that the draft regulations achieved the policy intent of capping or banning early exit charges and banning existing member-borne commission in certain occupational pension schemes. The Government intends to lay the revised regulations, which incorporate some of the views raised by respondents, before Parliament for their consideration in due course. The intention is for the regulations to come into force on 1 October 2017.

Respondents

Aegon UK

Association of Pension Lawyers

Association of School and College Leavers

Aviva

Capita

Eversheds Sutherland

Gowling WLG

Investment and Life Assurance Group

Law Society of Scotland

Mercer

The Society of Pension Professionals

Willis Towers Watson

CONSULTATIONS

The Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2017 – Draft regulations – Introducing a cap on early exit charges for members in occupational pension schemes and prohibiting existing member-borne commission charges in certain occupational pension schemes : Public consultation (April 2017)

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/605346/occupational-pensions-capping-exit-charges-and-prohibiting-member-borne-commission-charges-consultation.pdf

Capping early exit charges for members of occupational pension schemes : ensuring a fair and consistent approach across all defined contribution pensions – Public consultation (May 2016)

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/526040/consultation-capping-early-exit-charges-for-members-of-occupational-pension-schemes.pdf

Capping early exit charges for members of occupational pension schemes : ensuring a fair and consistent approach across all defined contribution pensions – Government response (November 2016)

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/567617/government-response-consultation-capping-early-exit-charges-for-members-of-occupational-pension-schemes.pdf

FCA : Capping early exit pension charges : consultation paper (CP16/15)

<https://www.fca.org.uk/publication/consultation/cp16-15.pdf>

FCA : Capping early exit pension charges : consultation paper - feedback on CP16/15 and final rules

<https://www.fca.org.uk/publication/policy/ps16-24.pdf>

Better workplace pensions : Banning member-borne commission in occupational pension schemes (October 2015)

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/470489/banning-member-borne-commission-consultation-oct-2015.pdf

Better workplace pensions : Banning member-borne commission in occupational pension schemes : Government response and consultation on draft regulations (January 2016)

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/494887/banning-commission-regs-consultation-jan-2016.pdf