



Institute
and Faculty
of Actuaries

Capping early exit charges for members of occupational pension schemes

IFoA response to the Department for Work and
Pensions

16 August 2106

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.



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16 August 2016

Dear Mr Moore

IFoA response to DWP Consultation into capping early exit charges for members of occupational pension schemes

1. The Institute and Faculty of Actuaries (IFoA) welcomes the opportunity to respond to DWP's consultation into capping exit charges. Members of the IFoA's Pensions and Life Boards have written this response. We have limited our response to those questions where the IFoA is able to provide a specific response.

General Comments

2. We welcome that the DWP and the FCA are consulting simultaneously on this matter. We regard consistency between trust and contract based schemes as important, as fairness should not depend on a legal structure. Trustees, administrators and providers should all be subject to the same approach.
3. Given the new obligations placed on the FCA by government in relation to contract based personal pensions schemes, we think the DWP proposals represent a reasonable and balanced approach that aims to be broadly consistent with the approach being taken by FCA.

Q1 Is there any reason why the government should not adopt this approach in relation to occupational pension schemes?

4. The IFoA agrees with the DWP in the use of the four principles for the exit cap.
5. In particular, the IFoA considers it important that tPR and the FCA approach this matter consistently to limit the extent of possible regulatory arbitrage.
6. The IFoA would highlight the limited existence of exit charges in occupational schemes suggested in tPR's survey.¹ Any proposed action should reflect the potential impact of change on only a small number of occupational schemes. There may be additional scheme specific factors that may mean schemes have fair reason to apply a penalty. This may not necessarily mean early exit charges are a deterrent to accessing pension freedoms (Para 2.7).

¹ <http://www.thepensionsregulator.gov.uk/exit>

Q2 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.

7. The IFoA supports the proposed application of a cap only to those aged over 55, as this is the age group government wants to target to ensure access to the new pension freedoms. We would recommend that any legislative change should cover future variability in the minimum age at which individuals could access pension freedoms. Using the age of 55 strikes a balance between individuals accessing pension freedoms and limiting losses to schemes that may incur from not recouping high initial costs.

8. With reference to tPR's survey, the size of the average charge in comparison to the average fund size does not appear significant.

Q3 Is there any reason why such a definition of early exit charges would not be suitable in relation to occupational pension schemes?

9. The IFoA is unaware of any reason.

Q4 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?

10. The analysis of paragraph 2.16 is correct. We welcome the DWP's acknowledgement that some members may benefit from exiting the scheme early while the scheme has been unable to recoup the costs incurred because of the member joining the scheme. We support DWP's desire to understand how exit charges reflect the recouping of initial charges.

Q5 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?

11. We welcome the approach taken to MVAs. They are not exit charges as considered by the initial DWP consultation, but rather a reflection that certain guarantees provided under a with-profits investment only apply at certain points in the product lifecycle (such as retirement close to the specified retirement age, or upon death). It would be inappropriate to extend these guarantees to other points during the contract as this could potentially have materially adverse impacts for other policyholders in the with-profits funds. In a worst-case scenario, it could affect the solvency of the insurer providing the with-profits fund.

Q6 Do you have any comments about the proposed approach to "terminal bonuses" and their exclusion from the definition of MVAs?

12. The operation of with-profits funds, including in relation to terminal bonuses and MVAs is subject of specific FCA rules (Conduct of Business Rules – Chapter 20.2 Treating With-Profits Policyholders Fairly). It would be sensible for DWP and tPR to work closely with FCA in defining how the new rules should operate for with-profits investments held by trust based pension schemes. The overarching principle should be that MVAs and terminal bonuses, determined in accordance with FCA rules, should only be affected by the rules on exit charges to the extent that any allowance is made for an exit charge within the calculation of the MVA or terminal bonus on surrender that would not be made for normal retirements or deaths. This may necessitate changes to FCA rules rather than require new DWP rules.

13. This does raise a wider issue where trust based schemes hold an insurance policy, or insurance policies, as assets backing the members' benefits (whether with-profits or unit linked). Rules applying to the pension scheme would not necessarily apply to the insurance policy, or the way proceeds from the insurance policy are calculated.

Q7 Would a similar definition of MVAs assist trustees or managers to determine what was in scope of an exit charge?

14. As MVAs only apply to with-profits funds, which in turn are operated only by insurance companies, it is not clear whether such a definition would be of any use or relevance to scheme trustees.

Q8 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?

15. The IFoA does not have any evidence about such schemes. Applying a percentage will result in members with large pots paying more in cash terms than members with smaller policies. However, it is common to express exit charges on insurance products in percentage terms and so the approach seems reasonable. An alternative approach would be to apply a maximum exit charge in cash terms, as it is unclear the work involved in processing an early exit would cost more depending on the size of the pot. However, applying a maximum monetary cap would be potentially complex and would lead to a higher impact on firms.

Q9 Is there any evidence to suggest that occupational pension schemes should apply a different level of cap to that applied to personal pension schemes?

16. The IFoA supports the application of a consistent cap between trust and contract schemes. The proposal to apply the requirements to providers, not just to pension scheme trusts, is essential. Otherwise, for trust schemes investing in insurance policies, the trust would have to make up any shortfall between the investments provided net of the full exit charge made by the provider and the proposed amount with a capped exit charge. Some trusts would have no assets (other than the investments earmarked to members' accounts) from which to make up any such shortfall and would have no mechanism under the trust deed and rules to seek reimbursement from the employer.

Q10 Do you agree with the levels of proposed cap?

17. Yes.

Q11 What is the risk that other charges or fees will be used to recoup costs?

18. This approach is a risk. It is possible to operate a number of different charging structures for very long-term contracts. In order to maintain a market for administrators and other service providers, the DWP should only introduce changes that support the continuation of that market. If the legislative changes lead to losses for these providers, the structure of future terms may change to minimise those losses.

Q12 What actions should the Government consider to mitigate this?

19. As noted in the previous paragraph, detailed restrictions could lead to a change in charging structures. The market will dictate charging structures. All providers, trust and occupational, have reduced charges over the last decade, to maintain market share.

Q13 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"?

20. Given the stated aims of the government, we consider the proposals are a reasonable and balanced approach that appears consistent with the approach taken by the FCA.

Q14 Are there any reasons why these arrangements would not be appropriate?

21. The arrangements override existing contractual agreements and such retrospective change generally reduces confidence and stability in the UK financial system. However, as the government has decided to pursue this policy, we are unaware of any other reasons why the proposed exit charge cap should not operate as set out in the consultation, subject to the government carrying out the further exploration referred to in paragraph 2.18.
22. Should you wish to discuss any of the points raised in further detail please contact Philip Duggart, Technical Policy Manager (Philip.duggart@actuaries.org.uk / 0131 240 1319) in the first instance.

Yours sincerely,



Fiona Morrison
Immediate Past President, Institute and Faculty of Actuaries