Title: Introducing a cap on early exit charges in personal and stakeholder (trust-based) occupational pension schemes	# Impact Assessment (IA)
IA No:	**Date:** 3/07/2017
RPC Reference No:	**Stage:** Final
Lead department or agency: Department for Work and Pensions	**Source of intervention:** Domestic
Other departments or agencies:	**Type of measure:** Secondary Legislation
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Summary: Intervention and Options

RPC: Awaiting scrutiny

Cost of Preferred (or more likely) Option			
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2014 prices)	**Business Impact Target Status**
-1.17	-9.29	1.0	Qualifying provision

What is the problem under consideration? Why is Government intervention necessary?

In April 2015, the then Government introduced the pension freedoms, which enable individuals aged 55 and over and who are members of a defined contribution (DC) pension scheme to access their pension pot as and when they want to (subject to their marginal rate of income tax, typically 20% or 40%). Members could access their pension through their current scheme or by transferring their savings to a scheme that offers flexible access options. Some providers may apply early exit charges to DC scheme members. This may act as a barrier to those members wishing to transfer their savings in order to access the new pension freedoms before they reach their scheme retirement age.

Following consultation, the FCA introduced rules establishing an early exit charge cap of 1% of the value of the member's benefits taken, converted or transferred for existing members of contract based schemes and a ban on such charges for new members of these schemes (i.e. those joining the scheme after the rules applied).The cap/ban came into effect from 31 March 2017.

The Government is introducing regulations to bring in the same level of cap/ban as that applied for contract based schemes to members of trust based schemes. The regulations will come into effect from 1 October 2017.

What are the policy objectives and the intended effects?

The policy objective is to ensure that members of trust-based occupational pension schemes are able to access the pension freedoms before their selected retirement age or scheme maturity date. The then Government made a public commitment to make it easier for these individuals to access the pension freedoms within the scheme or move between schemes to access their funds in the way they wish. There is also a need to ensure parity of treatment and protection for members of trust and contract-based pension schemes.

What policy options have been considered, including any alternatives to regulation?

This Impact Assessment considers the following options:

Option 0: Do nothing – so current exit charges will continue to apply in trust-based occupational pension schemes

Option 1: Introduce an exit charge cap at 1% of funds under management, with a 0% cap applied for all new schemes.

A voluntary option has been ruled out as, in order to meet the policy objective, it would be necessary for all trust-based occupational pension schemes and third-party pension providers to support a voluntary approach; otherwise some customers may still be unable to access their pension at reasonable cost. It is likely that those firms that chose not to cap charges would have higher exit charges than the rest of the market and be the source of the highest levels of consumer detriment. A legislative approach is the only option that ensures all members are protected.

At consultation stage various percentage levels of a cap were proposed and assessed, but they would not meet the objective of parity of treatment between trust and contract-based pension schemes.

Will the policy be reviewed? The policy will be kept under review			**If applicable, set review date:** N/A		
Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope?	**Micro** YES	**< 20** YES	**Small** YES	**Medium** YES	**Large** YES
What is the CO2 equivalent change in greenhouse gas emissions? (Million tonnes CO2 equivalent)			**Traded:** N/A		**Non-traded:** N/A

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister: ______________________ Date: 5/7/2017

Summary: Analysis & Evidence

Policy Option 0

Description: Do nothing (baseline)

FULL ECONOMIC ASSESSMENT

Price Base Year 2015	PV Base Year 2017	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	High: 0	Best Estimate: 0

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	0	n/a	0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised costs by 'main affected groups'

N/A

Other key non-monetised costs by 'main affected groups'

If a cap is introduced for contract-based schemes but not trust-based schemes there could be a cost to providers who serve both sides of the market from having to maintain two different processes for implementing exit charges.

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	0	n/a	0	**0**
High	0		0	**0**
Best Estimate	0		0	**0**

Description and scale of key monetised benefits by 'main affected groups'

N/A

Other key non-monetised benefits by 'main affected groups'

N/A

Key assumptions/sensitivities/risks **Discount rate (%)** 3.5

Under the baseline scenario members will continue to face exit charges as now. An estimated 1,900 members a year aged 55 and over are expected to be accessing their pensions early and paying an exit charge in the period observed, with between £0.91m and £1.24m estimated to be paid per year.

BUSINESS ASSESSMENT (Option 0)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target £m
Costs: 0	**Benefits: 0**	**Net: 0**	n/a

Summary: Analysis & Evidence   Policy Option 1

Description: Introduce an exit charge cap at **1%** of funds under management

FULL ECONOMIC ASSESSMENT

Price Base Year 2015	PV Base Year 2017	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: 0	**High:** 0	**Best Estimate:** -1.17

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	0.0	1	0.0	**0.0**
High	0.0		0.0	**0.0**
Best Estimate	0.2		1.2	**10.5**

Description and scale of key monetised costs by 'main affected groups'

There would be costs to trust-based occupational pension schemes, providers and administrators from the charges foregone totalling around £0.72m in the first year, which increases in each subsequent year, up to £1.40m.
There would be on-going administrative costs to schemes, providers or administrators from overriding existing charges each time a member exited the scheme early and the cap applied. In total these are estimated at £0.11m in the first and each subsequent year.
There would also be one-off familiarisation costs to schemes, providers or administrators to understand the scope of the cap, and where applicable, design a method for overriding the cap on a case by case basis. These are estimated at £0.22m in 2017. All figures are in 2015 constant price terms.

Other key non-monetised costs by 'main affected groups

There could be second order behavioural effects which have not been monetised. For example, from providers recouping costs elsewhere.

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	0.0	1	0.0	**0.0**
High	0.0		0.0	**0.0**
Best Estimate	0.0		1.1	**9.4**

Description and scale of key monetised benefits by 'main affected groups'

There would be benefits to members of trust-based occupational pension schemes where exit charges currently exceed the level of the cap. This is assumed to be equal to the costs to businesses from the charges foregone, at £0.72m in the first year, which increases in each subsequent year, up to £1.40m.

Other key non-monetised benefits by 'main affected groups'

Key assumptions/sensitivities/risks   **Discount rate (%)** 3.5

There are uncertainties over future volumes of members that will leave their schemes early and face an exit charge. We have assumed however, that the exit rate under a 1% cap will be the same as the current average exit rate for those with a 1% charge, and that the population in scope will be stable over the next 10 years. Given the lack of detailed data on the distribution of exit charges amongst trust-based schemes, we have assumed that the distribution is the same as for contract-based schemes.

We do not know how early members will choose to access their pension, so we use 10 years to calculate the cost to providers, though this represents an upper bound.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target £m
Costs: 1.1	Benefits: 0.1	Net: -1.0	5.0

Evidence Base (for summary sheets)

Problem under consideration

1. As of 6 April 2015, with the introduction of the pension freedoms, individuals aged 55 and over who have flexible benefits (Defined Contribution (DC) and cash balance benefits) are entitled to access their pension pot flexibly, regardless of their total pension savings. Before the introduction of these historic reforms, the vast majority of individuals would have been subject to a 55% tax penalty for withdrawing their pension benefits fully. Individuals are now able to access their flexible benefits as they wish, subject to their marginal rate of income tax (typically 20% or 40%). Individuals with defined benefit (DB) pension savings that are not already in payment can transfer their DB savings to a DC scheme if they want to access their pension savings flexibly, provided that they are more than one year away from their scheme retirement date.

2. The aim of the then Government was to ensure that everyone in a DC scheme can access their pension savings flexibly even if their scheme does not offer flexible access. To enable this it strengthened a members' statutory right to transfer pension savings between DC schemes, and empowered trustees and managers of pension schemes to override their own scheme rules in relation to transfers.

3. Whilst there is no requirement for pension providers to offer flexible access products to their scheme members, the pension freedoms encourage pension schemes and providers to innovate and develop products according to the needs of their scheme members in an evolving pensions landscape. The extended transfer rights ensure that people are not prevented from accessing their pension savings in the way that they want.

4. As individuals sought to engage with the new pension freedoms the then Government became increasingly aware that early exit charges were acting as a financial barrier to some members who decided to exit their scheme early before the selected retirement date in order to access their pension savings flexibly. The level of the exit charge (either in absolute terms or relative to the size of their pension pot) could, in some instances, be high enough that it is no longer cost effective for an individual to access their pension flexibly.

5. In a commercial and competitive pensions market it is reasonable that service providers are able to recoup appropriate costs incurred in setting up and running a pension scheme for the member. These costs are likely to include, for example, a joining fee, annual management charges, fixed policy fees and exit charges.

6. Many schemes impose additional charges on members who wish to access their pension before their selected retirement date. These charges include costs for transferring to another scheme which offers the pension freedoms and early exit charges.

7. In 2015, HM Treasury ran a public consultation to determine whether early exit charges applied by schemes were preventing consumers from accessing their pension savings

flexibly. The Financial Conduct Authority (FCA) and the Pensions Regulator (TPR) collected data on the prevalence of early exit charges. This data identified exit charges imposed on members aged 55 and over and who were members of contract-based and trust based schemes was acting as a deterrent preventing some members from accessing their pension flexibly. The data showed that the higher the level of the cap the less likely members were to exit their scheme.

8. Following the public consultation[1] the then Government announced in February 2016 that it would introduce legislation to ensure that early exit charges could be capped in personal and stakeholder (contract based) pension schemes[2].

Background

9. On 31 March 2017 the FCA introduced a cap on early exit charges of 1% of the value of the member's benefits being taken, converted or transferred for existing members of personal and stakeholder pension schemes (contract based schemes) and a ban on such charges for new members of these schemes (ie persons that joined the scheme after 31 March 2017).

6. In May 2016, the then Government published a consultation paper which sought stakeholders' views on proposals to introduce a similar cap or ban on early exit charges imposed on members of personal and stakeholder (trust-based) pension schemes and who are eligible to access the pension freedoms. This was supported by an Impact Assessment[3] and later by an ad-hoc publication, which included analysis of a 1% cap[4].

7. In November 2016 the then Government published its response to its May consultation and set out its intention to introduce and set restrictions on early exit charges for trust based pension schemes in line with those proposed by the FCA for contract based pension schemes. It also set out how it envisaged the cap on early exit charges to work in trust based pension schemes based on the feedback provided to the consultation and the evidence gathered by TPR and the FCA.

8. Consultation on the appropriate regulations introducing the cap or ban for trust based schemes has been completed. The Government published its response to the consultation on 3 July. It has made a public commitment to introduce the same level of cap as that applied to contract based pension schemes to members of trust based schemes – a cap of 1% of the value of the member's benefits taken, converted or transferred for existing members of trust based schemes and a ban on such charges for new members of these schemes. The regulations will come into effect from 1 October 2017.

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[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/449861/PU1847_Pensions_transfers_v4.pdf

[2] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/498871/pension_transfers_and_early_exit_charges_response.pdf

[3] https://www.gov.uk/government/consultations/capping-early-exit-charges-for-members-of-occupational-pension-schemes

[4] https://www.gov.uk/government/publications/impact-of-capping-early-exit-charges-in-occupational-pension-schemes

Rationale for intervention

10. The aim of the pension freedoms is to allow individuals aged 55 and over to access their savings flexibly. Exit charges have been found to act as a barrier to members wishing to access the freedoms. The policy objective is to introduce a cap at a level which will enable scheme members to take advantage of the pension freedoms whilst enabling service providers to retain the ability to recoup reasonable costs incurred in setting up and running a pension scheme for the member.

11. Providers do incur costs in setting up and running a pension scheme. There are three main ways that set-up costs have historically been recovered:

    - Set up costs paid up front by each saver. This means that the impact of charges is high at the start, but is lower going forward. Under this charging structure, there are no exit charges. Each saver pays their own set up costs but a saver who leaves the scheme before the selected retirement date will have lost a higher proportion of their contributions and fund value to charges arising from these initial charges.

    - Set up costs paid by everyone who remains in a scheme. All savers pay the same ongoing charge as a proportion of their funds, (for example though an annual management charge (AMC)) but no joining or exit charge. Because there is no joining or exit charge, the provider is likely to recover the set up costs of those savers that leave early by charging a higher ongoing rate, which will ultimately be paid by those savers that remain in the scheme. This means long term savers bear a share of the set up costs of savers who exit the scheme before the selected retirement age.

    - Set up costs paid over the lifetime or at exit. Savers do not pay an initial charge. However, should a saver leave the scheme before the selected retirement age they will pay an exit charge to cover the proportion of set-up costs that have not been recovered through regular charges (e.g. an AMC). This charge will diminish the longer the saver remains in the scheme. As all savers that exit a scheme pay their own set-up costs, these costs do not need to be recovered from savers that remain in the scheme for longer.

12. To inform the then Government consultation, the FCA and TPR collected data that indicated that early exit charges pose a potentially significant barrier for a minority of individuals in contract-based pension arrangements (regulated by the FCA) and trust-based pension arrangements (regulated by TPR) who wish to access their pension benefits flexibly.

13. FCA data from September 2015 showed that around 16% of consumers eligible to access their pension savings would be charged a penalty if they opted to leave the scheme before the selected retirement age in contract-based pension schemes. The majority (nearly 80%) of those where a percentage charge would apply, face a charge of up to 5% of the fund value[5].

[5] FCA pension freedoms data collection exercise: analysis and findings, September 2015

14. The TPR survey of flexible pension access[6], covering the same period, showed that 11% of trust-based schemes charged at least one exit charge, reducing to around 7% if just considering the types of exit charge that could be included in a cap[7]. Exit charges were more likely to be present in smaller, rather than larger schemes or Master Trusts. As the vast majority of trust-based pension scheme members are in Master Trusts or medium and large schemes this means up to 6% of members faced exit charges, reducing to around 3% for charges relevant to a potential cap. The average flat rate charge was £195 and the average percentage charge was 10% although the majority had charges ranging from 1% to 5%[8]. The most recent TPR survey[9] broadly confirms these findings with 3% of members facing exit charges and 4% of trust-based schemes charging an early exit charge which would be in scope of the cap.

15. To address this, the then Government legislated to give the FCA a duty to cap excessive early exit charges for members of contract based pension schemes. The cap (set at 1%) for members of these schemes came into effect on 31 March 2017. Failure to introduce an equivalent charge for trust-based schemes could lead to a distorted market, where only one part of the market will have a cap in place and regulatory arbitrage may occur.

16. Not aligning the cap for trust based schemes with that introduced for contract based schemes will create an anomaly in the pension industry, cause confusion for trustees, managers, and service providers administering pension schemes and an un-level playing field for schemes and their members. Prioritising protection of those in contract-based schemes over those in trust-based occupational pension schemes could damage the positive impact these measures would otherwise have.

17. When employers select a pension scheme for their employees they can select either an arrangement that is a bundle of individual contracts (termed a contract-based scheme) or a scheme operated under trust (termed a trust-based scheme). Trust-based schemes can be pre-designed by a pension provider and be linked to contractual arrangements between the trustees and the provider. Consequently, in effect, the pension scheme provider imposes the terms and conditions on the member of these trust-based schemes.

18. There needs to be the right balance between effective competition and appropriate consumer protection. The intention is not to prevent pension scheme providers from applying an early exit charge where this is already in place but to ensure the appropriate level is set to reflect the costs of running the scheme without placing excessive penalties on the consumer.

19. For trust-based schemes, discussions with the industry have revealed that early exit charges are mainly present in schemes set up in the 1980s and 1990s before the introduction of stakeholder pensions in 2000. At this time there were often significant costs incurred by the provider in setting up the trust- based scheme, including the costs of ‘selling’ the policy to the employer. A common practice to recoup these costs was for the provider to use a structure which levied higher charges in the first few years of membership

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[6] TPR: Survey of flexible pension access, September 2015

[7] For example, fees associated with setting up an Uncrystallised Fund Pensions Lump Sum (UFPLS) and Market Value Adjustments will not be included in an exit charge cap.

[8] These figures include two or three outliers which skew the average.

[9] TPR: Survey on Exit Charges in Defined Contribution (DC) Schemes, http://tpr.gov.uk/docs/survey-exit-charges-dc-2016.pdf

with the amount charged declining as the member converged on their normal pension age. Where the member left the scheme before the selected retirement age a charge was incurred to recoup the charges that would have otherwise been paid until the normal pension age.

20. Consequently, this type of charging structure will have been imposed by the underlying insurance provider rather than the trustees themselves. These charging structures had the benefit of having fewer upfront costs for the employer as the set up costs are recouped from the members themselves over time, and often there may have been loyalty bonuses for members that continue to contribute until their normal pension age. This would make the scheme attractive to the employer on the face of it, but would not necessarily be the best choice for the member, particularly where the member wishes to leave the scheme before the selected retirement age. This is an example of **information asymmetry,** where the complexity of the product creates difficulties for employers in making comparisons about costs, quality, and outcomes, which depend upon multiple factors and may not be judged for a number of years.

21. The result is that there are members of older trust-based schemes who had no choice about the charging structure of the scheme they entered, and may wish to leave the scheme early but face substantial charges. This is an example of the **principle-agent problem** where scheme members rely on employers to select a workplace scheme into which they are enrolled and their respective interests and incentives are often different. There is also a level of **information asymmetry** where employees are not likely to know why the employer has chosen this scheme, and in many cases would not be able to predict the effect of the charging structure on their outcomes in the future.

22. The then Government indicated intervention was required to address the information asymmetry and principle-agent problem so that members' interests are protected. There is clear economic rationale for this change. The charges act as a barrier to free choice of pension funds, locking in initial decisions that may now be sub-optimal, by punitive costs of changing provider. Where it may be optimal for individuals to change supplier if their preference is for early access to funds, high exit charges act as a penalty for doing so.

23. The then Government recognised that there are some costs to scheme providers involved in this process, therefore, charges would be capped to a level it believed reasonable to cover those. Increased mobility of funds in the market is expected to increase competitiveness and innovation in products over the longer term. People will no longer be tied to incumbent firms with products that no longer suit their needs.

24. The then Government understood that providers tend to impose charges across their entire book irrespective of whether the member is in a contract or trust-based scheme. Limiting a cap to contract-based schemes only would lead to inconsistencies of approach and could place additional burdens on those providers who would have to differentiate between those contracts supporting contract-based schemes and those supporting trust-based schemes.

25. Market value adjustments (MVAs) are not included in the definition of an early exit charge. These take the form of an adjustment to the underlying value of a person's rights in a with-profit fund contract when that individual leaves the scheme before their selected retirement date. The rationale behind this decision is that since customers are signing up to a long-term contract, early exits can disrupt insurers long-term pricing models built to incorporate long-term factors such as changes in interest rates.

Policy objectives

26. The policy objective is to address concerns that members of trust-based occupational pension schemes who have early exit charges imposed by the trustees or managers of the scheme are effectively prohibiting them from accessing the pension freedoms before their selected retirement age or scheme maturity date. The then Government stated its intention to make it easier for individuals to move between schemes to access their funds in the way they wish. They also wished to ensure that there is parity of treatment and protection for members of trust and contract-based pension schemes.

27. The then Government's consultation "Pensions Transfers and Early Exit Charges"[10] considered options to limit early exit charges and to create a level playing field where all consumers can access the new pension freedoms easily and at reasonable cost.

28. HMT placed a duty on the FCA to cap early exit charges in contract based schemes, which it did on 31st March 2017. Not introducing a cap on trust-based schemes would not meet the objective of parity of treatment between trust and contract-based pension schemes.

29. To address this, regulations will introduce a cap of 1% of the value of the member's benefits being taken, converted or transferred for exiting members of occupational pension schemes and a ban on such charges for new members of these schemes to ensure that members of trust-based schemes have the same protection as those now afforded in contract-based schemes.

Description of options considered

30. To deliver a cap on early exit charges, DWP and TPR have worked in partnership with the FCA to develop the design and level of the cap and align this between both contract and trust-based schemes. Part of the process involved looking at specific cost-benefit analysis and building on the data gathering exercises which have been undertaken by the FCA and TPR. The following options were considered.

Do nothing (Option 0)

31. This option represents the baseline where exit charges can continue to be charged at any level. This means that members who are in schemes with exit charges will continue to face costs that potentially deter them from accessing their pension savings. This would not meet the policy objective and was ruled out. It would also create an uneven market with a cap only in place for contract-based schemes.

Legislative Approach (Option 1)

32. The introduction of a legislative cap on early exit charges was the then Government's preferred approach. In order to be consistent across contract and trust-based sides of the market, regulations will require the same level of cap to be applied expressed as a percentage of funds under management.

    - Option 1: Exit charge cap at 1% of funds under management, with an exit charge cap at 0% of funds under management for all new policies from 1 October 2017;

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[10] https://www.gov.uk/government/consultations/pension-transfers-and-early-exit-charges-consultation

Voluntary Approach

33. A possible voluntary cap on early exit charges was ruled out during the "Pensions Transfers and Early Exit Charges" initial stage consultation. The primary benefit of a voluntary approach is that it could be implemented very quickly without the need for legislative intervention. Some providers and schemes have already announced they are considering how they can eliminate or reduce exit charges levied and some have committed to capping them[11]. However, in order to be effective, it would be necessary for *all* pension providers and trust-based schemes to support a voluntary approach; otherwise some customers may still be unable to access their pension at reasonable cost.

34. It is likely that those firms that chose not to cap charges (and instead face potential reputational damage) would have higher exit charges than the rest of the market and be the source of the highest levels of consumer detriment. A purely voluntary solution is unlikely to achieve the objective of removing the financial barrier that early exit charges pose to all consumers wishing to access their pension flexibly. The risk of non-compliance resulting in incomplete coverage means this option was also ruled out. Furthermore, there would be resulting challenges and costs in monitoring such a policy.

Monetised and non-monetised costs and benefits

35. A cap on exit charges, whether as a percentage or cash amount paid, would benefit affected members who wish to withdraw their pension funds or seek to move them between pension funds by reducing the charges paid and removing a potential actual, or perceived, barrier from being able to access the pension freedoms.

36. Pension schemes (or their third-party providers) that currently charge an exit charge above the level of the cap will face a loss of revenue. The costs to business from charges foregone are calculated as the difference between the total amount of exit charges paid with and without a cap, combined with the amount lost from Annual Management Charges (AMCs), that will not be levelled against any members that leave as a result of the cap after they exit.

37. The costs of lost revenue for providers are net of the additional revenue from exit charges (capped at 1%) levelled against members who will choose to leave as a result of the cap. (In the baseline these members would choose to stay in their existing scheme).

38. There will also be some administrative costs to pension schemes and administrators from familiarisation with the new rules and implementation of the cap.

39. Potential costs and benefits of a ban on early exit charges (effectively a 0% early exit charge cap) for new members have not been monetised here, this is due to early exit charges being an issue predominantly in

[11] For example, one provider has committed to capping exit charges at less than 5%. http://www.ftadviser.com/2016/03/14/pensions/personal-pensions/prudential-cuts-charges-by-and-scraps-exit-fee-AFUG5Yo4XLk34eXA4hbvnK/article.html

older pension schemes, as referenced in the Financial Conduct Authority's cost-benefit analysis[12]. Furthermore, in the event that there were any future scheme members anticipated to pay early exit charges in the baseline, given that the ban on early exit charges for these members is in place before new members are set up, scheme providers have the flexibility to adjust their pricing models to recoup any potential losses from the outset.

Number of members in a DC scheme where early exit charges currently apply

40. TPR data[13] shows there are 6,931,000 members of trust-based DC schemes or DC sections of hybrid schemes with over 12 members in. There are 95,000 members who are in micro-schemes with fewer than 12 members, of which we estimate that around 13,500 are members of Executive Pension Plans (EPPs)[14].

41. A TPR survey on exit charges shows that around 4% of trust-based DC members in schemes with 12 or more members face an early exit charge of the type that would be in scope of a cap[15].

42. For Small Relevant Schemes (SRS) with between 2 and 12 members, intelligence from FCA suggests exit charges tend to be more prevalent, particularly for the subset that are Executive Pension Plans[16] (EPPs) where up to 70% may incur early exit charges.

43. Applying 4% to those schemes with more than 12 members and those with less than 12 members who are not EPPs gives **286,900 members** with a pension subject to an early exit charge. Applying 70% to the EPP volumes gives an estimate of **9,500 members** subject to an early exit charge.

Baseline volume of members who will exit and are subject to an exit charge

44. Of all trust-based DC members facing exit charges, only those aged 55 and over are eligible to access their pensions and, therefore, would be affected by any cap. An estimated 12% of trust-based DC members in schemes with 12 or more members are aged 55 and over[17].

45. Members in EPPs are generally older than those not in an EPP. An estimated 24% of members in an EPP are aged 55 or over[18].

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[12] https://www.fca.org.uk/publication/consultation/cp16-15.pdf

[13] TPR - DC trust: a presentation of DC scheme return data 2015-16. The figure includes members of DC only schemes, dual-section hybrids schemes and micro schemes. http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-a-presentation-of-scheme-return-data-2016.aspx

We have elected to use 2015/16 data as exit charges are most commonly a legacy issue, and the large increase in the number of members this year is predominantly due to automatic enrolment, and these members will almost certainly not have exit charges.

[14] Information provided by TPR.

[15] TPR 'Survey on Exit Charges in Defined Contribution (DC) Schemes' May 2016. http://tpr.gov.uk/docs/survey-exit-charges-dc-2016.pdf. TPR excluded micro-schemes (with between 2 and 11 members) from the survey to maintain consistency with other data collection and research.

[16] An Executive Pension Plan (EPP) is an occupational money purchase arrangement normally used for a small number of directors and senior employees.

[17] DWP calculation from TPR scheme return data 2015/16 on the number of trust-based members aged 50+ and the proportion of active DC members aged 55-59 from Annual Survey of Hours and Earnings (ASHE) 2015.

[18] Office for National Statistics: Annual Survey of Hours and Earnings https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/annualsurveyofhoursandearnings/2013-12-12

46. From this we estimate there are approximately **36,400 members aged 55 and over** who could be in schemes subject to a charge (12% of the 286,900 members of any age and 24% of the 9,500 EPP members).

47. Not all of these members would necessarily want, or need, to exit their scheme before their scheme retirement date. An estimate can be derived by considering the take-up of the pension freedoms to date. In an FCA report in the first six months from the introduction of the pension freedoms, 6.3% of people in a DC scheme aged 55 and over chose to exit[19].

48. Data from the FCA with more detail of the exit rate of those with early access charges, is shown in Table 1 which suggests that the exit rate amongst those with an early exit charge is lower (indicating that higher charges are aching as a deterrent). A weighted average of this data shows that 5.2% of those with an early exit charge chose to exit.

49. As the first six months following the introduction of pension freedoms includes an element of 'pent-up' demand, we have adopted the FCA's approach[20], which assumed that the exit rate would normally be half of what was experienced in the first six months; the exit rate over a whole year is, therefore, assumed to be 5.2%.

50. As a result we have estimated that the number of people with exit charges that will exit in the baseline and regardless of the cap from 2017 onwards will be around **1,900 annually**[21].

The level of exit charges

51. The TPR survey of flexible pension access for trust-based schemes shows the average flat exit charge was £195 and the average percentage charge was 10%[22], although the majority had charges ranging from 1% to 5%. However, given the small sample sizes, it is difficult to know more precisely how the levels of charges are distributed.

52. As an alternative, more accurate way to estimate, we have used the range of charge levels applied in contract-based schemes, derived from FCA's data collection from September 2015. Several large pension providers have reported to the FCA, that where they operate in both the contract and trust side of the market, their charging structures for the two markets are aligned or very similar, so it is reasonable to apply the range of charge levels in contract-based schemes to trust-based schemes[23].

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[19] FCA – Retirement Income Market Data, July to September 2015, published January 2016.

[20] https://www.fca.org.uk/publication/consultation/cp16-15.pdf

[21] This calculation provides illustrative future volumes based on an assumption that the population is static over time. While the section of the population affected by exit charges and choosing to exit is relatively small, population increases were calculated, and these increases in the wider population could make a significant difference to the results. We discuss this further in the risks and assumptions section.

[22] TPR: Survey of flexible pension access, September 2015

[23] The Impact Assessment was published alongside the consultation and no trust-based providers responded to disagree with the assumption that was presented to use the contract based distribution in this situation.

53. The FCA data provides the proportion of pots relating to members aged 55 and over that fall into different bands of exit charges. These assumptions are consistent with HMT analysis on the impacts of an exit charge cap for contract-based schemes[24]. We have used the same assumptions from the FCA Impact Assessment for the current exit rates by band of exit charge. These are shown in Table 1.

54. The contract-based side of the market was found to have 16% of members facing a charge whereas we have estimated for the trust-based side that 5% of members face a charge (this is 4.12% of those members in a scheme of more than 12 members and micro schemes ignoring EPPs and 70% for a small number of EPPs). We have assumed the distribution of the contract-based side by exit charge band for those with more than 0% exit charge also applies to the trust-based side of the market. Table 1 shows the estimate we have reached for the volumes of the 1,900 annual early exits by band.

[24] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/498871/pension_transfers_and_early_exit_charges_response.pdf

Table 1: FCA data for contract-based pensions exit charges; estimated distribution of trust-based members facing an exit charge by band of charge

Bands of charge as % of fund value (midpoint)	FCA data for contract-based pensions			Assumptions for trust-based pensions	
	Exit rate	Proportion of pots in the band	Proportion of pots with >0% exit charge	Proportion of pots in the band	Volume of trust-based members exiting annually in baseline
0%	6.50%	83.60		94.71	
0-1% (0.5%)	6.30%[25]	5.94	36	1.92	831
1-2% (1.5%)	4.80%	2.83	17	0.92	302
2-5% (3.5%)	4.60%	4.04	25	1.30	412
5-10% (7.5%)	4.40%	1.98	12	0.63	191
>10% (15%)	4.10%	1.61	10	0.52	147
Total	**6.30%**	**100**	**100**	**100**	**1,883**

55. To estimate the amount of exit charges foregone in the trust-based market place, we have used the average pot size from the joint DWP and FCA report on charges in legacy (pre 2001) pension schemes[26]. This gives a mean pot size for those exiting their pension of **£15,333**.

56. We expect that member's pots would increase in value over time, we have therefore applied a 0.55%[27] annual management charge (AMC) to the pot, followed by 3.47%[28] investment returns every year. This has the effect of increasing the average pot size, and therefore the amount of charges paid, year on year. Years 1 and 10 have been shown in the table below, with the years in between having charge levels between these two values.

Exit charges foregone with a 1% cap

57. There will be a cost to business of reduced revenue from exit charges applied to members who leave early.

58. For the purposes of this assessment we have used the percentage cap rather than a flat monetary cap, given this has been introduced for contract based pension schemes and will be used for trust based pension

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[25] The average exit rate for the market as a whole happens to be the same as for those with charges between 0 and 1%

[26] DWP and FCA: 'Remedying Poor Value Legacy Workplace Pension Schemes: Findings from the Joint Review of Industry Progress against the Independent Project Board Recommendations' December 2016. This is appropriate as the data collection in this work was aimed at pre-2001 schemes that were deemed to be of poor value by the Independent Project Board (the types of scheme in which exit charges are most prevalent), and exit charges were covered in the data collection for this report.

[27] DWP: Charges Survey 2015. https://www.gov.uk/government/publications/pension-charges-survey-2015-charges-in-defined-contribution-pension-schemes

[28] This is based on a 4.75% growth on equites and 1.55% growth on bonds with an assumed 60/40 split between equities and bonds respectively.

schemes. Exit charges are often expressed in percentage terms as many of the costs incurred by exiting a pension scheme are proportionate to the size of the pension pots.

59. Table 2 below shows the charges foregone where there is a percentage cap imposed at 1% of assets under management (AUM) on all existing contracts instead of the baseline. For example, with a 1% cap the charges on the 831 pension pots with an exit charge of between 0 to 1% would remain the same as before. The 302 pots where the charge is between 1 and 2% would, however, only pay the capped 1% rate.

Table 2: Charges faced by trust-based members who would exit early regardless of a cap assuming an initial average pot of £15,333

Baseline charge band as % of fund value	Volume exiting regardless of cap	Baseline costing			With a 1 % cap		
		Assumed exit charge(midpoint of band)	Amount in exit charges (year 1)	Amount in exit charges (year 10)	Assumed exit charge	Amount in exit charges (year 1)	Amount in exit charges (year 10)
0-1%	831	0.50%	£63,700	£86,400	0.50%	£63,700	£86,400
1-2%	302	1.50%	£69,500	£94,300	1.00%	£46,300	£62,900
2-5%	412	3.50%	£221,100	£300,000	1.00%	£63,200	£85,700
5-10%	191	7.50%	£219,700	£298,100	1.00%	£29,300	£39,700
>10%	147	15.00%	£337,800	£458,400	1.00%	£22,500	£30,600
Total	**1,883**	**-**	**£911,800**	**£1,237,200**	**-**	**£225,000**	**£305,300**

60. In subsequent years we assume the same distribution of charge levels apply, and that the same number of members would be affected in each year. The estimated cost to business is £911,800 - £225,000 = **£686,800 in the first year** and £1,237,200 - £305,300 = **£931,900 in year 10.** Table 3 below indicates the lost revenue to business in each year as a result of the cap.

Table 3: Exit charges forgone in each year as a result of the 1% cap

Year	**Difference in exit charge revenue before and after the 1% cap**
2017	£686,700
2018	£710,300
2019	£734,900
2020	£760,300
2021	£786,500
2022	£813,600
2023	£841,700
2024	£870,800
2025	£900,900
2026	£931,900
Total	**£8,037,600**

61. Through their data collection exercise, the FCA determined that the majority of members with exit charges are in legacy schemes, and, therefore, the number of members facing exit charges this year will diminish over time[29]. As we have not been able to establish to what extent this may be the case for trust-based pensions we have not calculated changes to the number of people facing exit charges over time. This could overstate the value of exit charges lost by firms over the ten year appraisal period.

Benefits from charges from additional members exiting as a result of the cap

62. The exit charge acts as a deterrent to members moving their pension scheme, so with a cap we will see additional members leaving. The costs of lost revenue for providers are net of the additional revenue from exit charges (capped at 1%) levelled against members who will choose to leave as a result of the cap.

63. We have assumed that the new exit rate for each charge band will be the same as the exit rate for members currently with a 0-1% charge, that is, 6.3%. So, for example, earlier we estimated that from the 1,900 early exits a year, 302 members are in the band with a 1-2% exit charge. These currently have an exit rate of 4.8%. With an exit rate of 6.3% there would be an additional 94 leavers (94 = (6.3% / 4.8% * 302) - 302).

64. We estimate that businesses will benefit by between **£62,400 and £84,700 annually** from charges from additional members leaving their existing schemes. The calculations are shown in Table 3. These are members that we believe will chose to exit as they would have preferred to have left their scheme before, but their exit charge acted as a barrier.

Table 4: New charges gained as a result of additional members leaving early under the cap

[29] https://www.fca.org.uk/publication/data/pension-freedoms-data-collection-exercise.pdf

Baseline charge band as % of fund value	Exit charge with a 1% cap	Additional exits as a result of the cap	Charges revenue from additional exits (year 1)	Charges revenue from additional exits (year 10)
0-1%	0.50%	0	£0	£0
1-2%	1.00%	94	£14,400	£19,600
2-5%	1.00%	152	£23,300	£31,600
5-10%	1.00%	82	£12,600	£17,100
>10%	1.00%	79	£12,100	£16,400
Total	**-**	**407**	**£62,400**	**£84,700**

65. Table 5 below shows the charges revenue from additional exits in each year.

Table 5: additional revenue in each year from people who will choose to exit as a result of the cap

Year	Extra revenue gained as a result of further members leaving
2017	£62,400
2018	£64,600
2019	£66,800
2020	£69,100
2021	£71,500
2022	£73,900
2023	£76,500
2024	£79,100
2025	£81,900
2026	£84,700
Total	**£730,500**

Costs from reduced annual management charge revenue

66. There will be a cost to business through reduced revenue from the AMC as a result of additional members leaving their pension early. These members may transfer to another pension scheme but may use the money in other ways.

67. The average AMC from the DWP charges survey is 0.55%[30]. We estimate that each member leaving costs business a full year of AMC at 0.55% of an average pot size of £15,333 in the first year, increasing each year as estimated previously.

68. In Table 4 we estimated an additional 407 exits annually. In the first year this means there is a cost to business of 407 * 0.55% * £15,333 = **£34,300**.

69. Providers will lose not only the AMC in the year that the member left but also in subsequent years. We do not have information on how early members would chose to leave compared to their normal retirement date. We have, therefore, assumed that the cost to business will accumulate each year over the ten years of the policy. Since members can access pensions from the age of 55 and the state pension age for men is 65 and for women is currently equalising to 65 then this is not an unreasonable assumption though will tend to overstate the cost since not everyone will access as early as 55, and in some schemes the retirement age may be lower than 65.

70. Over the ten year period from 2017 to 2026 we estimate there will be a cost to business of **£2,321,800** from reduced AMC due to additional leavers.

Table 6: AMC foregone as a result of additional members leaving early under the cap

Year	**Additional members leaving within the year**	**Accumulated additional members leaving**	**Cost to business of reduced AMC from additional members leaving**
2017	407	407	£34,300
2018	407	814	£71,000
2019	407	1,221	£110,100
2020	407	1,628	£152,000
2021	407	2,035	£196,500
2022	407	2,442	£244,200
2023	407	2,849	£294,700
2024	407	3,256	£348,000
2025	407	3,663	£405,000
2026	407	4,070	£466,000
Total	**4,070**		**£2,321,800**

Total cost to business through loss of early exit charge revenue

71. The total net cost to business for charges foregone under the 1% cap is detailed in Table 5. Over the ten year period there is a net cost to business of **£9,941,000**.

Table 7: Total net charges foregone as a result of the cap in the first year of the policy

[30] https://www.gov.uk/government/publications/pension-charges-survey-2015-charges-in-defined-contribution-pension-schemes

Year	Total cost to business (as a result of 1% cap for exits that would have occurred in the baseline)	Total benefits to business (revenue generated through early exit charges paid by additional members leaving as a result of the lower cap)	Net cost to business
2017	£721,000	£62,400	£658,600
2018	£781,300	£64,600	£716,700
2019	£845,000	£66,800	£778,200
2020	£912,300	£69,100	£843,200
2021	£983,000	£71,500	£911,500
2022	£1,057,800	£73,900	£983,900
2023	£1,136,400	£76,500	£1,059,900
2024	£1,218,800	£79,100	£1,139,700
2025	£1,305,900	£81,900	£1,224,000
2026	£1,397,900	£84,700	£1,313,200
Total over ten years	**£10,359,400**	**£730,500**	**£9,628,900**

Benefits to members from a cap

72. Members who wish to exit their current scheme early so they can access flexible retirement options, and who currently face an exit charge will potentially benefit from the introduction of the cap depending on when they became a member of the scheme (i.e. before or after 1 October 2017). Assuming schemes do not attempt to recoup this revenue by other means, the total benefit will be equal to the costs to business of the charges foregone. Therefore, the estimated total benefits to affected members in the first year will be **£721,000** under the 1% cap. In each subsequent year the benefit to consumers will correspond to the reduction in exit charges for members who would have exited anyway, added to the AMC they will not pay to the provider, which increases each year (see Table 4). This does not include any benefits of potential increased competition.

73. The assumption that businesses do not recoup the costs of the charges foregone is uncertain. The 2014 legacy audit review[31] assessed exit charges and suggested that they were often introduced as a means to recoup set-up costs. In schemes without exit charges this would likely be done either through a joining charge or just through the AMC. There is the possibility that capping exit charges could indirectly lead to schemes increasing the AMC or discretionary payments for remaining members to compensate. If this were to occur it would be an indirect effect and has not been monetised in this Impact Assessment (either as lower costs to business or reduced benefits to members). However, there are reasons why this is less likely to occur:

[31] https://www.abi.org.uk/~/media/Files/Documents/Publications/Public/2014/Pensions/Defined%20contribution%20workplace%20pensions%20The%20audit%20of%20charges%20and%20benefits%20in%20legacy%20schemes.pdf

- Any default arrangements in schemes that provide money purchase benefits and are used for Automatic Enrolment are subject to the existing charge cap which would limit the extent that the AMC could be used to recoup costs in these schemes
- Due to exit charges not being spread evenly across the market, providers who increase their AMC to recoup the cost of charges forgone will be making themselves less competitive and market forces should dictate that the trustees will move to another provider at the next opportunity to protect their members' interests
- There is anecdotal evidence that some large providers have already started to eliminate early exit charges and are able to absorb the cost of doing so
- The responses to consultations, and in discussions and debates during the passage and introduction of the Pensions Act 2017, raised few concerns that an early exit charge cap would have a detrimental impact on business or to scheme members. Indeed, some pension scheme providers voluntarily introduced an early exit charge cap and, to our knowledge, this also had little or no adverse effect on their business.

Costs to members from a cap

74. There will be a small extra cost to members of **£62,400** in the first year, and increasing throughout the appraisal period. This is due to more people choosing to leave than when there is no cap, and those members having to pay exit charges that are capped at 1%. While we have assumed the people in this scenario would not have exited under the baseline, they would only do so if they judged the benefits from leaving to be greater than the costs where they had not before.

Administrative costs of implementing the cap

75. The amount of time it takes scheme providers to administer the proposed cap would depend on a wide variety of factors, including:

    - The number, scale and complexity of those amendments that might be required
    - The level of automation in how the charge is calculated and applied
    - The extent of literature updates needed
    - Whether contracts with providers need to be renegotiated
    - Whether or not the cap is expressed in similar operational metrics as those used by the firm to operate and calculate the charge.

76. Some firms may choose to implement upfront system changes to incorporate the cap, and will consider if this will be more cost-effective in the long-run than overriding the system on a case by case basis. Engagement with providers suggests that the costs involved in making system changes varies with some saying it is insignificant and others suggesting costs are much higher. As it will be for individual providers to determine how best to implement the cap, the costs of upfront system changes have not been considered here.

77. In addition, as the Government has already signalled its intention to introduce a cap on early exit charges in trust-based pensions, the providers of these schemes will already face costs to implement the cap. By legislating to introduce the same level of cap as that applied to contract-based schemes, providers which service both contract and trust-based schemes will be able to align their systems rather than have different

processes, creating possible cost savings. The FCA has already implemented a cap for contract-based schemes.

78. Some providers have already chosen to introduce a cap on exit charges across all of their occupational pension schemes[32]. This shows that some firms will have implemented these changes before the cap comes into effect without them being required to by law, and that these changes are unlikely to be overly burdensome. If they were it would be more likely that firms would wait until they were sure that they would have to comply with the law before making changes to their systems.

79. However, for the purpose of this Impact Assessment, we have assumed that, at a minimum, businesses would continue using their existing systems and implement the cap by manually overriding the system. This is due to the low number of members affected by the cap in each year, as we believe that providers will not implement up front changes unless the cost is lower than carrying it out manually

80. The work involved in verifying that the exit charge has breached the cap is assumed to be 4 hours of a pension administrator's time for every customer that is affected by the cap. This assumption is based on HMT discussions with industry and is consistent with FCA's cost-benefit analysis[33]. We did not receive any information through the consultation process to suggest that this was not appropriate. The wage level of a pension administrator is assumed to be £19.05 per hour (including non-wage costs)[34] which gives a unit cost of £76.20 per override in 2015/16 prices.

81. In each year of the policy there are 1,052 members exiting early with an exit charge of more than 1% (Table 1) and 407 additional members leaving (Table 4) which gives a total of 1,459 members affected annually.

82. The estimated administration costs annually are 1,459 * £76.20 = £111,200. These are the total costs that would apply to insurance providers, administrators or the trustees depending how schemes are governed.

Familiarisation costs

83. There will be one-off costs to administrators, insurers or trustees of trust-based schemes to familiarise themselves with the rules of the change and check whether their scheme is in scope of the cap. The Government has carried out public consultations on the level and scope of the cap for trust-based schemes and has signalled its intention to cap early exit charges for members of these schemes from 1 October 2017. The concept will be familiar to many in the pensions industry.

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[32] https://www.ftadviser.com/2016/03/01/pensions/scottish-widows-scraps-workplace-pension-exit-fees-TfMKrmphRrlYV09VngEPUJ/article.html

[33] https://www.fca.org.uk/publication/consultation/cp16-15.pdf

[34] This estimate is based on the assumption that pension's administration is likely to be a higher wage paying profession than general administration. The estimate of £19.10 is based on the gross median hourly rate for an associate professional, which has then been increased by 27% in line with the Green Book to account for non-wage costs. The hourly rate data is in 2014 prices and taken from the most recent available ASHE, 2015: http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip

84. For schemes which don't have exit charges this should be all that is required and is assumed to take around 1 hour[35] for a professional with a wage level of £25.08[36] (giving a unit cost of £25.08).

85. For schemes that have early exit charges, and for the administrators and insurers that service schemes with early exit charges, the familiarisation will be more substantial as we assume they will also need to incorporate (i) a one-off task for a compliance officer to construct a method to override the system and sets out the steps needed in an operational guide, and (ii) time for training for operational staff to learn the required manual override method. Based on HMT calculations and assumptions[37], we assume it takes the compliance officer at each affected business 24 hours at an hourly wage level of £25.08 to complete the familiarisation. In addition, it is assumed that 10 operational staff will take 2 hours each to complete the training with an hourly wage of £19.05[38]. This gives a total unit cost of £983 per business.

86. TPR have previously advised that 200 unique insurers, administrators and Master Trusts provide services to the vast majority of DC schemes[39]. It is assumed that all of these service at least one scheme which levies early exit charges so the unit cost of £983 will apply.

87. This leaves around 260 unbundled DC schemes which are either self-administered or have no administrator recorded by TPR where the trustee (or the sponsoring employer) would need to do the familiarisation themselves. Of these, around 4% are assumed to apply exit charges (based on the latest TPR evidence[40]) and a £983 unit cost is applied. For the remaining 96% the basic unit cost of £25.08 will apply.

88. Approximately 9% of hybrids and DB schemes self-administer[41], although we do not know the exact number of hybrids that self-administer, we have assumed that the proportion is the same as it is from hybrids and DB combined. This leads to 82 hybrid schemes having to familiarise with the new rules. Again we assume 4% of these will face a unit cost of £983 and 96% will face a unit cost of £25.08.

89. This gives familiarisation costs of £209,400 for the businesses and schemes where exit charges apply, and £8,200 for schemes which do not levy exit charges with a total of **£217,500 i**n 2015/16 prices.

Familiarisation costs for micro-schemes

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[35] This assumption is based on reading and digesting at least 12 pages of regulatory guidance based on average reading speeds.

[36] The estimate of £25.08 is based on the gross median hourly rate for a professional, increased by 27% in line with the Green Book to account for non-wage costs. It is assumed that a single professional employee would undertake this work. The hourly rate data is in 2015/16 prices and taken from the Annual Survey of Hours and Earnings (ASHE), 2016:
https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/datasets/occupation2digitsocashetable2

[37] HMT Impact Assessment on introducing an exit charge cap for contract-based schemes

[38] This estimate is based on the assumption that pension's administration is likely to be a higher wage paying profession than general administration. The estimate of £19.10 is based on the gross median hourly rate for an associate professional, which has then been increased by 27% in line with the Green Book to account for non-wage costs. The hourly rate data is in 2014/15 prices and taken from the most recent available ASHE, 2015:
http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/2015-provisional-results/rft-2.zip

[39] These figures have previously been used in the DWP Risk Warnings Impact Assessment, March 2016

[40] Findings to be published in due course

[41] Information provided by TPR

90. Micro-schemes, which have between 2 and 11 members, account for 92% of the total trust-based market, but only 1% of total trust-based membership[42]. These are not specifically included in the number of businesses calculated above to estimate the familiarisation costs. However, the vast majority of micro schemes, including EPPs, will be in bundled arrangements and use an insurance provider already included above. Approximately 70% of micro schemes use an external administrator[43] and will therefore not have to familiarise themselves.

91. It also known that approximately 84% of micro schemes are classified as Small Self-Administered Schemes (SSASs), where all members of the scheme are trustees[44]. It is assumed that as these members would carry out their own transfer in the case of an early exit that they would not familiarise until they decided to exit, which they would already do under the baseline scenario. The remaining 1,500 schemes may choose to familiarise with the new rules, but it is unlikely that they would have to do so until they received a transfer request.

92. However, even if the trustees do self-administer the scheme, the nature of the familiarisation required will be negligible, and at a minimum, the trustees will only need to familiarise themselves with the requirements on the rare occasion that a member wants to leave the scheme before the selected retirement age and an exit charge above the cap applies. As the assumed rate of exit is 6.3%, the number of members potentially affected is very small. It is unlikely that work to construct an override upfront will be required and would likely form part of usual business. Therefore, we do not expect micro-schemes to be adversely affected[45].

Risks and Assumptions

Proportion of members subject to an early exit charge

93. Since the previous Impact Assessment was carried out, further information around the distribution of charges for members in contract-based schemes was made available to us. We chose to use this data as it was more reliable than those used in the previous Impact Assessment, and allowed us to change the assumption that people would make the choice to leave their scheme once, rather than repeatedly[46]. We do not have any reason to believe that the distribution of early exit charges would be significantly different from contract-based schemes, and no information was received within the consultation to suggest otherwise.

94. The evidence used for this Impact Assessment predominantly comes from FCA and TPR surveys on exit charges. There is inherent uncertainty in the results from any survey where it is based on a sample of the population but these surveys achieved good coverage with 94% and 87% of members covered in the

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[42] DC trust: a presentation of scheme return data 2015-2016, TPR

[43] Information provided by TPR

[44] TPR Scheme Returns 'File 5: Micro Schemes' http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2017.aspx

[45] This is in line with assumptions made for similar regulatory changes, such as the requirement to signpost members to Pension Wise.

[46] https://www.gov.uk/government/consultations/capping-early-exit-charges-for-members-of-occupational-pension-schemes

September 2015 FCA and TPR surveys respectively. Although the sample sizes are relatively small for trust-based schemes with exit charges, the results from the most recent TPR survey are reasonably consistent with the first.

95. Due to the lack of uniformity in the application of exit charges as identified in the FCA's data collection exercise[47], we have assumed that providers will not be able to recoup the lost revenue from the cap. This is because competition in the market would result in the firms who had applied exit charges (and had lost revenue as a result of the cap) having higher charges, which would cause them to lose business to other firms. If this were to happen it would have the effect of reducing costs for businesses and increasing them for members through annual management charges (AMC).

Process and cost assumptions

96. There is some uncertainty around the processes and costs involved in implementing the cap because of the wide variation in how exit charges are applied. An Impact Assessment was published alongside the 2016 consultation[48] and we received no responses which indicated that our assumptions are incorrect or who raised any concern over implementation and systems costs. Therefore, we believe these assumptions are reasonable.

97. Due to the comparatively small number of members who face an early exit charge and are aged 55 and over, we do not think that a system change would be proportionate under these circumstances. We have, therefore, not included it in this Impact Assessment.

Proportion estimated to access their pensions early with an early exit charge

98. The pension freedoms were introduced in April 2015 and the pensions landscape is still evolving with new products coming on the market. It can take members a long time to decide whether to withdraw their pensions[49] so there is some uncertainty over the proportion we expect to access early, at the age at which they would access early.

99. We have assumed that those accessing their pensions early and who are subject to an early exit charge are as likely as those without an early exit charge to access them. It may be that those who are in schemes with early exit charges, even capped at 1%, may be less likely to leave than those without them and so the estimates we have shown may be overstated.

Population assumptions

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[47] FCA "FCA pension freedoms data collection exercise: analysis and findings" April-June 2015 https://www.fca.org.uk/publication/data/pension-freedoms-data-collection-exercise.pdf

[48] https://www.gov.uk/government/consultations/capping-early-exit-charges-for-members-of-occupational-pension-schemes

[49] Research by Ignition House followed 80 people who had said there were going to make a decision in 2015. Eight months on from then over a half had still not decided what to do. http://bandce.co.uk/wp-content/uploads/2017/04/16047_SSGA_TPP-SSGA-Joint-Research_FINAL-COMPLIANCE-APPROVED.pdf

100. We have implicitly assumed that there is no change over time in the volumes of members who would access their pensions as a result of population changes.

101. The Office for National Statistics population projections show that between 2017 and 2026 (the ten years the policy is assumed to cover in this assessment) the volumes of 55 year olds would vary between +5% and -1% from the volumes in 2017. These are the groups who would become eligible for accessing their pension freedoms. This would lead to a variance in the total costing of between -£0.07m and £0.38m.

102. Some of this population change could be driven by migration which would not necessarily lead to an increase in those with the early exit charges since these pensions were sold predominantly in the 1980s and 1990s.

103. We have assumed that those with early exit charges are evenly split over the population whereas it is more likely that those with early exit charges are older than without them as they are a relatively old product. The FCA used a four year appraisal period in their cost benefit analysis due to exit charges being predominantly a charge levelled against policies in the 1980's and 90's. They therefore did not expect a significant number of exit charges to be in place beyond 2020[50]. Due to these reasons it seems likely that the change in population size along with this fact could cancel each other out, so for simplicity we have assumed the split of early exit charges is even, and would not decrease over time as may be expected.

104. The FCA used a four year appraisal period in their cost-benefit analysis[51], as they believed exit charges to be largely a legacy issue, with reducing prevalence as time goes on. We have elected to use a ten year appraisal period due to the uncertainty around the prevalence of exit charges among members in the near future, and that the costs of lost AMC revenue could still impact providers for up to 10 years if members are accessing their pots in their 50's.

Total costs and benefits

105. The total costs and benefits to businesses and consumers are detailed in table 6 below

Table 8: Total estimated costs and benefits of this policy

Description	Cost or benefit	Affected group	Recurring?	amount in one year (£)	Direct cost/benefit to business?
Familiarisation	Cost	Business	No	£0.22	Y
Administration	Cost	Business	Yes	£0.11	Y
AMC forgone	Cost	Business	Yes	£0.03 - £0.47	Y
Exit charges forgone	Cost	Business	Yes	£0.69 - £0.93	Y
New members leaving facing exit	Cost	Members	Yes	£0.06 - £0.08	N

[50] https://www.fca.org.uk/publication/consultation/cp16-15.pdf

[51] https://www.fca.org.uk/publication/consultation/cp16-15.pdf

charges					
Exit charges from new members	Benefit	Business	Yes	£0.06 - £0.08	Y
Reduced exit charges	Benefit	Members	Yes	£0.69 - £0.93	N
AMC not being paid	Benefit	Members	Yes	£0.03 - £0.47	N

Direct costs and benefits to business

106. The equivalised annual net direct costs to business (EANDCB) are estimated at £1.0m for a 1% cap. These are assessed over a 10 year period from 2017.

Wider impacts

Indirect impacts on consumers

107. There would be benefits to individuals from being able to choose the best possible option for using their retirement savings, rather than being constrained due to exit charges acting as a barrier. For example, if individuals are withdrawing their pensions to pay off debts, it is likely to cause a quantifiable monetary benefit to the individuals concerned as the interest on debts are often higher than the interest accrued on pensions.

108. We do not believe that there will be a risk to pension savings in the long run as a result of this proposal. There were no suggestions in the consultation responses that this is likely to be the case.

109. Regulations will also restrict service providers from increasing costs where an existing early exit charge is below the 1% cap. This is particularly relevant in the case of schemes under Automatic Enrolment where a 0.75% charge cap applies. For example, the service provider cannot increase their costs above the 0.75% level. We also do not believe the impact on business as a result of these proposals to be so great that they would it would warrant actions that would pose a risk to pension saving in the long run.

110. There is a risk that consumers could choose to withdraw more of their savings at aged 55 with the cap in place, but the policy intent is to give individual members the freedom to choose how and when to access their pension from age 55. Given the limited information on how members are responding to the pension freedoms, it is difficult to determine whether they are changing schemes or which decumulation product(s) they may be entering into. We have used observed exit rates for those who currently experience an exit charge lower than the level of the cap to assume the average rate of exit after the cap is implemented. The policy objective is to allow members to access the pension freedoms when they want to, failure to do so could cause member detriment.

Transfers to business

111. When members exit they may not necessarily be taking their pots as cash themselves, they may be moving them to another provider who offers more of the pension freedoms. This would represent transfer with respect to the AMC forgone to the ceding provider. As this move is at the member's discretion we have considered it as indirect for the purpose of this assessment.

Impact on competition

112. It is possible that by reducing exit charges and limiting the extent to which providers and administrators recoup set-up and commission costs, providers will be more selective in the schemes they take on, with fewer providers willing to provide for schemes where there is high turnover of staff. This may create more consolidation of the market in the future with fewer, larger providers.

113. However, by removing excessive early exit charges customers will be able to freely choose between different providers and access the full range of pension freedoms at a reasonable cost, instead of effectively being forced to stay with their existing provider. This greater customer mobility could have competition benefits by enabling customers to move to providers and products that best suit their needs.

Reduced funds under management

114. It is possible that some firms may be adversely affected as a result of having fewer funds under management, on the other hand many of these pots will move to other schemes where they will remain invested. We believe our analysis in this case is proportionate to the burden imposed on business

Small and Micro Business Assessment

115. The pension providers and administrators affected are typically large businesses servicing a number of schemes, including micro-schemes, although there will be a minority of smaller businesses also. However, even where small and micro-schemes are self-administered the number of members affected by the changes will be very small indeed and the work required to cap the relevant charges is not likely to be a separate, one-off task but instead will be part of their usual business. Therefore, we do not expect any micro-schemes to be adversely affected.

116. The primary objective of the policy is to allow all customers to access the new pension freedoms easily, and at a reasonable cost. Exempting any subset of pension providers from the proposed cap would potentially leave some customers with significant levels of early exit charges that would discourage them from accessing the new pension freedoms. Therefore, granting small and micro businesses a full exemption from the proposed cap would not be compatible with the aims of the policy.

117. No evidence was received from the consultation that the cap would have a disproportionate impact on small and micro-businesses.

Implementation of preferred options

118. The Government has signalled its intention to bring the cap or ban on early exit charges for members of trust based schemes with effect from 1 October 2017. This will afford the same protection as those members in contract-based schemes.