

EXPLANATORY MEMORANDUM TO
THE OCCUPATIONAL PENSION SCHEMES (CHARGES AND GOVERNANCE)
(AMENDMENT) REGULATIONS 2017

2017 No. 774

1. Introduction

- 1.1 This Explanatory Memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

- 2.1 This instrument introduces restrictions on early exit charges for members of occupational pension schemes eligible to access the pension freedoms. These freedoms enable individuals aged 55 and 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%). This is either via their current scheme or by transferring their savings to a scheme that offers flexible access options.
- 2.2 It also covers the second phase of the member-borne commission ban in certain occupational pension schemes used for automatic enrolment by prohibiting charges being imposed on members to recoup the cost of commission payments made to advisers in relation to commission arrangements entered into before 6 April 2016.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

- 3.1 None.

Other matters of special interest to the House of Commons

- 3.2 As this instrument is subject to negative resolution procedure and has not been prayed against, consideration as to whether there are any other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 Section 41 of the Pension Schemes Act 2017 amends paragraph 6 of Schedule 18 to the Pensions Act 2014 to allow the Secretary of State to make regulations to provide that any term in a relevant contract which is inconsistent with the regulations made under Schedule 18 is overridden. These Regulations make such provision which applies to both the capping of early exit charges and the banning of existing member-borne commission charges.
- 4.2 Schedule 18 to the Pensions Act 2014 allows the Secretary of State to make regulations which set limits on or prohibit particular types of administration charges, including exit charges. The Occupational Pension Schemes (Charges and Governance) Regulations 2015 (the 2015 Regulations) impose obligations on trustees and managers of certain occupational pension schemes in relation to charges imposed by those schemes.

- 4.3 The Pension Schemes Act 2015 introduced the concept of ‘flexible benefits’, which covers the pension arrangements to which the new freedoms will apply and allows pension scheme members with such benefits a statutory right to transfer between schemes up to and beyond their scheme’s normal retirement age. It also gives pension scheme members a statutory right to transfer a category of benefit in circumstances where they are no longer accruing rights in that category.
- 4.4 This instrument imposes a ban on early exit charges for members of occupational pension schemes aged 55 or over who joined the scheme on or after 1 October 2017 and a 1% cap for such members who joined the scheme before 1 October 2017. The Financial Conduct Authority Pension Schemes (Restrictions on Early Exit Charges) Instrument 2016 (FCA2016/72), made in accordance with the requirement in section 137FBB of the Financial Services and Markets Act 2000, makes similar provision in relation to private pension schemes.
- 4.5 The Government announced that no scheme used for automatic enrolment should contain member-borne commission payments to advisers from April 2016. The first phase involved introducing the Occupational Pension Schemes (Charges and Governance) (Amendment) Regulations 2016¹. These Regulations amended the 2015 Regulations to prohibit service providers from imposing a charge on members of an occupational pension scheme to recoup payments that the service providers made to advisers where the member’s employer, or former employer, used the scheme for automatic enrolment from 6 April 2016 and the agreement between the trustees or managers of the scheme and the person providing administrative services to the scheme was entered into on or after this date.
- 4.6 This instrument amends the 2015 Regulations to implement the second phase of the member-borne commission ban by preventing charges being imposed on any member whose employer, or former employer, has used the scheme for automatic enrolment to recoup the cost of commission payments made to advisers. This includes where the relevant contract between the trustees or managers of the scheme and the person providing administrative services to the scheme was entered into before 6 April 2016 and where the scheme was used by the member’s employer, or former employer, for automatic enrolment before this date. An exception is made where the commission payment was made before these Regulations come into force.

5. Extent and Territorial Application

- 5.1 The extent of this instrument is Great Britain.
- 5.2 The territorial application of this instrument is Great Britain.
- 5.3 Northern Ireland will be making separate parallel provisions.

6. European Convention on Human Rights

- 6.1 As the instrument is subject to the negative resolution procedure, and does not amend primary legislation, no statement is required.

7. Policy background

- 7.1 The Regulations have two purposes:

¹ <http://www.legislation.gov.uk/uksi/2016/304/contents/made>

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

Capping early exit charges

- 7.2 Following a public consultation the Government announced in January 2016 that it would introduce legislation to ensure that early exit charges could be capped in personal pension schemes. The Financial Services and Marketing Act 2000 was amended to give the Financial Conduct Authority (FCA) a duty to make rules to ban or cap early exit charges in personal and stakeholder pension schemes. 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 and a ban on such charges for new members of personal and stakeholder schemes.
- 7.3 On 15 November 2016, the Government published its response² to its consultation paper “Capping early exit charges for members of occupational pension schemes – ensuring a fair and consistent approach across all defined contribution pensions”³. This consultation sought stakeholders’ views on proposals to introduce a cap or ban on early exit charges imposed on members of occupational pension schemes who are eligible to access the pension freedoms. The consultation ran in parallel with a FCA consultation on the cap for personal and stakeholder pension schemes “Capping early exit charges” CP/16/15⁴.
- 7.4 The Government’s response set out its intention to introduce and set restrictions on early exit charges in line with those proposed by the FCA for personal pensions – a cap of 1% of the value of the member’s benefits being taken, converted or transferred for existing members of occupational pension schemes and a ban on such charges for new members of these schemes. It also set out how it envisaged the cap on early exit charges will work in occupational pension schemes based on the feedback provided to the consultation and previous evidence gathered by The Pensions Regulator and the FCA.

Banning member-borne commission charges

- 7.5 In their 2013 market study of the defined contribution workplace pensions market the then Office of Fair Trading (OFT) recommended that pension schemes with commission should not be used for automatic enrolment⁵. The OFT found that some members may be paying commission without realising it and that commission was a barrier to switching. Advisers were unlikely to want to lose their commission income stream by recommending a switch to another commission free pension arrangement that may offer better value for money for members.

² 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

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/526040/consultation-capping-early-exit-charges-for-members-of-occupational-pension-schemes.pdf

⁴ <https://www.fca.org.uk/publications/consultation-papers/cp16-15-capping-early-exit-pension-charges>

⁵ http://webarchive.nationalarchives.gov.uk/20131101164215/http://www.oft.gov.uk/shared_of/market-studies/oft1505

- 7.6 In March 2014, the Government announced that from April 2016 occupational pension schemes used for automatic enrolment would be prohibited from containing member-borne commission payments to advisers⁶.
- 7.7 In response to its October 2015 consultation "*Better workplace pensions: Banning member borne commission payments in occupational pension schemes*" the Government announced in January 2016 that it would take a phased approach to fulfil its commitment to ban member-borne commission payments to advisers in occupational pension schemes used for automatic enrolment. The Government explained that the complexity of making legislation to ban existing member-borne commission payments meant it was unlikely they would be ready to come into force on the 6 April 2016.
- 7.8 The first phase of the member-borne commission ban involved introducing regulations which came into force in April 2016 banning member-borne commission charges in schemes used by the member's employer, or former employer, for automatic enrolment where the agreement between the trustees or managers of the scheme and the person providing administrative services to the scheme was entered into on or after 6 April 2016. The FCA made rules that banned member-borne commission in workplace personal pension schemes used for automatic enrolment from April 2016.
- 7.9 These Regulations implement the second phase of the member-borne commission ban by prohibiting charges being imposed on members in schemes used by the member's employer, or former employer, for automatic enrolment in relation to contracts between the trustees and managers of the scheme and those providing administrative services to the scheme that were entered into before the 6 April 2016 and which were not renewed or varied after that date.
- 7.10 In line with the approach taken by FCA to its commission ban in workplace personal pension schemes, these Regulations do not prohibit charges being imposed on members in relation to payments made to advisers before the Regulations come into force on 1 October 2017. In addition, following consultation and engagement with industry stakeholders and others the Regulations also allow service providers up to six months in which to make any necessary changes to their systems and processes in order to comply with the Regulations.

8. Consultation outcome

- 8.1 This instrument was subject to an eight week consultation from 5 April to 31 May 2017⁷. 12 responses were received with overall agreement that this instrument met its intended purpose. Queries raised primarily related to drafting and minor technical points and requests for more clarification on some aspects of the instrument. 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 Regulations have been amended where appropriate.
- 8.2 There were more substantive queries around member-borne commission charges. These primarily related to:

⁶ <https://www.gov.uk/government/consultations/better-workplace-pensions-a-consultation-on-charging>

⁷ 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

- the relevant date of the prohibition and the amount of time given to service providers to comply with the ban on existing member-borne commission, and
- the expectation the Government had that member-borne charge levels would reduce following the removal of existing member-borne commission arrangements.

- 8.3 The Government agreed with respondents that the original drafting of the Regulations inadvertently resulted in service providers being given a much longer period than six months to remove existing member-borne commission arrangements. The Regulations have been re-drafted to make clear that the new prohibition takes effect on 1 April 2018, six months after the Regulations come into force. A longer period, will only be allowed where the service provider needs to request more information from the trustees or managers about former workers in order to comply. The drafting has also been changed 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 date.
- 8.4 The Government stated in the consultation document that members should benefit from the prohibition of member-borne commission charges and it expected to see a reduction in charge levels following the removal of existing member borne commission arrangements. The Government does not see its current role 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 it has indicated that it will take further action if members do not benefit. The Government has published surveys⁸ of pension scheme charges and these provide a useful view of charge levels in the automatic enrolment market. In addition, trustees or managers are now required to assess the value for money to members of the costs and charges in their schemes. This includes commission.
- 8.5 In relation to the ban on early exit charges the Regulations were redrafted to remove a provision that required trustees and managers of relevant schemes to ensure that where multiple early exit charges are imposed on scheme members the combined value came within the 1% cap. The consultation asked a specific question exploring whether there were any situations where an early exit charge could be imposed on a member by more than one service provider in relation to single scheme. The consultation responses did not identify any specific cases where multiple charges could apply. Consequently it was decided that provision did not need to be made in the Regulations to cover multiple charges.
- 8.6 The findings and the Government's response can be found at : https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/624295/government-response-occupational-pensions-capping-exit-charges-consultation.pdf

9. Guidance

- 9.1 The Regulations also provide for the Secretary of State for the Department for Work and Pensions to issue guidance from time to time on how the value of a member's benefits are to be calculated for the purposes of the early exit charge cap. This guidance is available at : <https://www.gov.uk/government/publications/occupational-pensions-capping-early-exit-charges>

⁸ <https://www.gov.uk/government/publications/pension-charges-survey-2015-charges-in-defined-contribution-pension-schemes>

10. Impact

10.1 Assessments on the impact of these Regulations have been made.

Capping early exit charges

10.2 The Government has modelled the potential impact of various cap on existing occupational pension schemes. The details of the analysis was included in the Impact Assessments:

- “Introducing a cap on early exit charges in trust based occupational pension schemes”⁹
- “Additional analysis of the impact of capping early exit charges for members of occupational pension schemes: summary of the expected impact of a 1% cap on early exit charges”¹⁰.

10.3 These were published alongside the May 2016 consultation. These showed a range of costs to pension schemes, providers and administrators of £5.37 million in the first year and £0.66 million in subsequent years with a 1% cap down to £1.85 million in the first year and £0.20 million in subsequent years with a 10% cap. There were benefits to members of £4.66 million in the first year and £0.61 million in subsequent years with a 1% cap down to £1.50 million in the first year and £0.20 million in subsequent years with a 10% cap.

10.4 A final stage Impact Assessment covering the introduction of the 1% cap on early exit charges has been prepared to accompany the Regulations. This has been submitted to the Regulatory Policy Committee (RPC) as part of the fast track procedure and will receive an opinion from RPC in due course. This shows an estimated cost to pension schemes, providers and administrators of £0.83 million in the first year up to £1.51 million in the 10th year of the policy plus an additional one-off cost of £0.22 million in the first year. Benefits to business totalled £0.06m in the first year and £0.08m in the 10th. There were benefits to members of £0.72 million in the first year up to £1.40 million in the 10th year. The Impact Assessment can be found at:

<http://www.legislation.gov.uk/ukia>

Banning member-borne commission in occupational pension schemes used for automatic enrolment

10.5 Drawing on consultation, stakeholder engagement and other sources an Impact Assessment was made on the effect the commission ban, on both new and existing arrangements, might have on advisers and service providers. This showed that the ban would impose an annual net cost to business of around £1.2 million over a ten year period. The regulations introduced in April 2016 banning new member-borne commission arrangements accounted for approximately £0.01 million of this cost with the remaining being a result of these Regulations banning existing commission arrangements. No impact on charities or voluntary bodies was foreseen. The detail is contained in:

- “Banning member-borne commission in occupational pension schemes used for automatic enrolment”, which was published in December 2015¹¹.

⁹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525859/impact-assessment-cap-on-early-exit-charges-in-trust-based-occupational-pension-schemes.pdf

¹⁰ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/526134/occ-pen-exit-charges-ad-hoc-analysis.pdf

10.6 All three assessments are available on the Gov.UK website.

11. Regulating small business

11.1 This instrument applies to activities that are undertaken by small businesses where such small businesses are service providers or trustees or managers under the legislation. However, the Government anticipates that very few, if any, small businesses will be affected by the legislation.

12. Monitoring & review

12.1 The Regulations provide for the Government to review the effect of the amendments to regulations 11A to 11C of the 2015 Regulations, which relate to the ban on member-borne commission charges. The first review is to be completed by 6 April 2021 to coincide with the deadline for the first review of The Occupational Pension Schemes (Charges and Governance)(Amendment) Regulations 2016 that originally inserted regulations 11A to 11C.

12.2 The Government has considered the need for a review of the Regulations relating to the capping of early exit charges in accordance with sections 28 to 32 of the Small Business, Enterprise and Employment Act 2015. The cap of up to a level of 1% will only apply to members of occupational pension schemes who joined the scheme prior to 1 October 2017, and only to those eligible to access the pension freedoms. The numbers of scheme members to whom the cap will apply will decrease over the course of time with the impact on trustees/managers and service providers being reduced accordingly. Giving consideration to these facts a review would be at disproportionate cost. Accordingly, the Minister considers that it is not appropriate in the circumstances to make provision for review in these Regulations in relation to the regulatory provision contained in inserted regulations 13A to 13E.

13. Contact

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¹¹ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/494298/impact-assessment--banning_member-borne_commission-in-ae-schemes.pdf