EXPLANATORY MEMORANDUM TO

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (EARLY EXIT PENSION CHARGES) REGULATIONS 2016

2016 No. 1079

1. Introduction

1.1 This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 To specify those charges that are not to be treated as early exit charges for the purposes of section 137FBB of the Financial Services and Markets Act 2000 ("FSMA"), which imposes a duty on the Financial Conduct Authority ("FCA") to make general rules prohibiting authorised persons from imposing specified early exit charges on members of relevant pension schemes.

3. Matters of special interest to Parliament

Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None.

Other matters of interest to the House of Commons

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

4. Legislative Context

4.1 Section 137FBB of FSMA requires the FCA to make rules preventing specified early exit charges being imposed on members of pension schemes who take, convert or transfer pension benefits after they have reached normal minimal pension age but before their expected retirement date. This instrument makes provision specifying matters that are not to be treated as early exit pension charges for the purposes of section 137FBB.

5. Extent and Territorial Application

5.1 This instrument extends to all of the United Kingdom.

5.2 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

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

7. Policy background

What is being done and why

7.1 The instrument makes provision specifying matters that are not to be treated as early exit pension charges for the purposes of an FCA cap on early exit charges faced by individuals who seek to access their pension before their selected retirement date, under the pension freedoms.

7.2 Market Value Adjustments, sometimes referred to interchangeably as Market Value Reductions, are adjustments generally found in "with profits" products or similar products, which are offered by insurers directly to members via personal pension schemes or indirectly via occupational pension scheme investments. They are reductions that may be made to the nominal value of a member's pension benefits when they exit a pension scheme early in order to more closely align them with the market value of the assets which those benefits are comprised of at the point at which the member exits the scheme.

7.3 In its consultation on "Pensions transfers and early exit charges" (July 2015) and in its Consultation response, the Government made it clear that it did not consider that MVAs should be treated as exit charges for the purposes of the FCA cap. This is because, although they may appear as a reduction to the consumer, the aim of an MVA is to return an individual to their 'share' of the pension scheme at the point at which they exit, as opposed to a nominal figure that may be quoted to them in their pension statement. We understand that where an MVA is properly applied it will follow accepted actuarial practices, for example, it would be consistent with the Insurance Technical Actuarial Standard (Part E – The Exercise of Discretion in Long Term Insurance Business), and will be applied on a consistent basis to all scheme members.

7.4 The investments to which MVAs may be applied are long-term in nature and backed by asset models that assume continued participation to a particular point, usually selected retirement age. Consequently, early exits can disrupt providers' long-term asset models which are built to incorporate long-term factors such as changes in interest rates. This is demonstrated by the fact that MVAs tend to reduce or fall away entirely as a saver approaches their selected retirement date.

7.5 Providers may use different criteria for applying MVAs, for example, when a policy is surrendered (partly or wholly); when benefits are taken from a pension policy before the selected retirement date; when an investment is switched out of a with-profits investment fund into another fund (which could include the conversion of a with profits annuity to a non- profit annuity) or when a withdrawal is taken.

7.6 These regulations set out that adjustments to the value of a member's pension benefits made in the course of calculating the surrender value of those benefits, or adjustments to the means by which that value is calculated, should not be treated as charges for the purpose of the FCA cap.

7.7 To ensure that exiting members are not unduly penalised however, these regulations makes clear that where a member has a reasonable expectation that they are entitled to the value of certain benefits, such as a terminal bonus, at the point of surrender an adjustment to that value which is an early exit charge (as defined in section 137FBB FSMA) is to be treated as such, and the exclusion does not apply.

Consolidation

7.8 This instrument stands alone, so consolidation is not appropriate.

8. Consultation outcome

8.1 In its consultation on "Pensions transfers and early exit charges" (July 2015) and in the Consultation response, the Government made it clear that it did not consider that MVAs should be treated as exit charges for the purposes of the FCA cap.

8.2 As set out in the government response[1] (February 2016), the July consultation received 74 responses, including 34 from industry (including the Association of British Insurers and the Pensions Lifetime and Savings Association, as well as individual firms) and 30 from consumer representatives and individuals (including Which?, Age UK, Citizens Advice, and the Financial Services Consumer Panel).

8.3 Respondents were broadly content that MVAs, which cannot properly be considered exit charges as there is no underlying 'claim' to these assets, should be excluded from the terms of any cap. Conversely, were they to be included, this could significantly impact on the business models of life insurers, who would potentially be required to pay individuals sums to which they were never entitled – fundamentally impacting on fairness to other consumers where these amounts would have to be subsidised by other scheme members.

8.4 The government consulted further on the definitions contained within these regulations as part of its consultation on "Capping early exit charges for members of occupational pension schemes" (July 2016). This consultation received 29 responses[2], not all of who responded to the specific questions on MVAs. Responses to these questions came predominantly from professional associations (including the Society of Pension Professionals, the Association of Pension Lawyers, and the Institute and Faculty of Actuaries) and individual firms.

8.5 Comments received as part of this consultation process were taken into consideration when preparing this instrument. In addition, this instrument was developed in co-ordination with the FCA and relevant industry stakeholders.

9. Guidance

9.1 HM Treasury will not be issuing guidance to accompany the instrument.

9.2 The FCA provides guidance on their rules where this is appropriate.

10. Impact

10.1 An assessment of the impact of the policy of capping early exit pension charges on the costs to business and the voluntary sector was published in the course of Parliament considering the Bank of England and Financial Services Bill.

10.2 A separate impact assessment of the effect that this instrument will have on the costs of business and the voluntary sector has not been prepared.

10.3 There is no impact on the public sector.

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

[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

11. Regulating small business

11.1 The legislation does not apply to activities that are undertaken by small businesses.

12. Monitoring & review

12.1 The instrument does not contain a requirement to conduct a separate review in relation to it. The Economic Secretary to the Treasury, Simon Kirby MP, has made the following statement: "In my view, and having had regard to "Small Business, Enterprise and Employment Act 2015 – Statutory Guidance for Departments", it is not appropriate to make provision requiring the review of the provisions of the Financial Services and Markets Act 2000 (Early Exit Pension Charges) Regulation 2016. Such a provision would be disproportionate taking into account the economic impact of this Order."

12.2 HM Treasury will however monitor the practical effects of the instrument.

13. Contact

13.1 Amit Kamal at HM Treasury (telephone: 020 7270 4725 or email: amit.kamal@hmtreasury.gsi.gov.uk) can answer any queries regarding the instrument.