Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Pension Transfers and Exit Charges Consultation
Consumer Issues Unit
HM Treasury
1 Horse Guards Road
London SW1A 2HQ

20 October 2015

Dear Sir, Madam,

**Financial Services Consumer Panel response to the consultation on pension transfers and early exit charges**

This is the response of the Financial Services Consumer Panel (the Panel) to the government consultation on pension transfers and early exit charges.

We are not clear why Market Value Adjustments (MVAs) are outside the scope of the consultation. The reason given – MVAs are a way for providers to recoup the cost of an early exit and prevent disruption to their long-term pricing models – seems inconsistent with the inclusion of similar charges. For example, charges related to the divestment of certain assets and the recovery of an initial commission payment previously paid to an adviser, are arguably also related to pension providers' long-term pricing models.

The opacity of MVAs and their application have long been a bone of contention for consumers. From the consumer perspective, the only number that matters in the pounds and pence they pay to exit a scheme. We have therefore included MVAs as an exit charge in our response and would urge the government to reconsider its position on this point.

As regards the implications of the pension freedoms more broadly we would encourage the government to consider the recommendations made by the Work and Pensions Select Committee in its recent report on pension freedoms advice and guidance.

In particular, the Panel supports efforts to develop a more holistic Pension Wise service, which takes into account consumers' individual financial situation, including debt, benefits and non-pension assets. We also believe the government should undertake research to ascertain what people do with their pension pots once withdrawn in cash, to ensure the reforms are delivering good outcomes for consumers.

Yours sincerely,

S.F. Lewis

Sue Lewis
Chair
Financial Services Consumer Panel

**Consultation Questions**

The Panel has only answered questions where it has substantive comments.

## Exit charges and fees

**Question 1: Do you have any evidence as to the scale and quantum of fees and charges that members might incur for leaving their scheme or accessing their benefits early?**

Although the Panel has no evidence of its own on the fees consumers pay to access their pot before the retirement date specific in their policy, it is possible to draw some broad conclusions from figures published by the FCA and the Pensions Regulator (TPR).

The FCA*'s Pension freedoms data collection exercise: analysis and findings report*[1] states that 84% (3,416,000) of consumers eligible to access their pension savings (i.e. aged over 55) in the period 6 April to 30 June 2015 would not have been charged on exit. It is not clear what proportion of those who accessed their benefits would have done so 'early' (i.e. before the stated retirement age for their pension product. In addition, these figures exclude with-profits policies, and therefore MVAs. It is important for the government or FCA to collect this data to get a full picture.

The FCA report[2] also shows, for customers aged 55 or over, 4,000 people would have incurred an exit charge which was more than 40% of their fund value, while 17,000 would have incurred a charge of 20-40% of their fund value. Although the percentage of consumers potentially incurring these relatively high levels of charges is low, these charges represent a large proportion of their savings and could have a detrimental impact on retirement income.

The *Survey on pensions freedom access* by TPR[3] shows a minority of schemes (11%) apply at least one exit cost or charge (either as a fixed fee or a percentage of pot size), while 89% of schemes do not. The option most likely to incur a charge from schemes was an uncrystallised funds pension lump sum (UFPLS).

ABI data[4] shows that most people accessing their pension since the reforms entered into force in April 2015 have taken a cash lump sum using UFPLS. If this trend persists over the longer term, it is possible that exit charges will affect an increasingly large proportion of consumers in the future.

**Question 2: Are you aware of any evidence of charges that are levied at, or above, an individual's selected pension age? Are there any examples of customer detriment as a result of late exit penalties, and charges at an individual's selected pension age?**

Although MVAs do not apply at the selected retirement date/maturity of the contract, if a consumer chooses to remain invested in a with-profits policy beyond their retirement date, it is possible they will be charged an MVA when they exit.

[1] https://www.fca.org.uk/news/pension-freedoms-data-collection-exercise-analysis-and-findings
[2] Ibid
[3] http://www.thepensionsregulator.gov.uk/doc-library/research-analysis.aspx#s20048
[4] https://www.abi.org.uk/News/News-releases/2015/09/Payments-made-to-savers-since-the-pension-reforms-reach-nearly-2-5-billion-ABI-stats-show

There may be agreed MVA-free dates within the relevant contracts (e.g. up until 3 months beyond the selected retirement date or every fifth anniversary). However, consumers do not know how much the MVA will cost until it is applied, so cannot determine whether they will face an excessive exit fee if they leave outside these MVA-free dates.

**Question 3: In your view, what would constitute an 'excessive' or unfair early exit charge? Please include any fees and charges that you would consider to be outside this definition and why.**

"Excessive" and "unfair" can have two different meanings.

It is possible for a charge to be unfair but not excessive, for example, a charge the consumer is not made aware of at the point of sale, or one that is presented in such a way that the consumer could not possibly understand what the charge might be for or how it is calculated. Such charges could be small: it is the lack of transparency that generates the unfairness.

An excessive charge is one over and above the reasonable costs to the provider of the early exit, and which therefore appears to be punitive. Many of the larger early exit fees are applied to reimburse the provider for significant amounts of commission paid to financial advisers, predominantly for products sold in the 1980s-1990s.

The levels of commission paid (and thus the early exit fees applied to recover them) may, in hindsight, be excessive, but are consistent with commission and fees charged at the time. It could be argued, therefore, that these fees are proportionate and reasonable so cannot be judged 'unfair'.

On the other hand, it is unlikely that consumers contracting with providers on this basis had an adequate understanding of the charges that were being imposed and how this would affect them should they decide to withdraw their fund early. If charges and the implications of these charges were not known, or could not be known or understood they might well be considered 'unfair'.

It is also important to note that many of the legacy schemes where exit charges apply may themselves be levying (or have levied) Annual Management Charges (AMCs) and other charges above the market average, in some cases well above the market average.[5]

In this context, these high AMCs and other charges may have already allowed the provider to be reimbursed for the upfront costs of establishing the scheme and paying commission. To allow the provider to make further additional profit from levying an exit charge may be considered both excessive and unfair.

**Question 5: How could the simplicity and transparency of market value adjustments and other investment deductions (as opposed to exit charges) be improved to increase customer understanding of such fees?**

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[5] The OFT found that workplace pension schemes established prior to 2001 had an AMC which was 26% higher than schemes established post-2001. Schemes set up prior to 2001 were also more likely to have other types of charges levied in addition to the AMC (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) .

The fact that MVAs exist, and the circumstances in which they may be applied, should be clearly communicated to customers of with-profit policies at point of sale. Up until now this has not been the case and consumers are often unaware that they will be charged an MVA until it is applied.

Consumers should also be notified clearly of any periods when they may cash in their with-profits policy without an MVA being applied. There are often specific days when no MVA will be charged (for example on the anniversary date of the policy or after a certain number of years) but these so-called 'MVA-free' days are often buried away in the policy terms and conditions.

The method of calculating MVAs should be standardised to ensure firms present the calculations clearly and transparently. Consumers could then make an informed decision as to whether they should surrender the assets.

In this context, we believe the FCA should review the rules in COBS 20.2.11-20.2.16R, which deal with surrender payments under with-profits policies. In particular, it is concerning that firms are allowed to deduct from policies costs that might have been incurred if the policy had remained in force.

**Question 6: The government would welcome views on the pros and cons of each of the 3 approaches to addressing excessive early exit fees set out in paragraphs 2.26 to 2.30. In particular, the government would be interested in views on particular components of an exit fee or other charges that should be considered to be in scope of any limit, and evidence on what might be the right level for any cap.**

*Caps on all excessive early exit fees*

The risk with capping one type of charge is that firms just make up the loss by increasing charges elsewhere. This is likely to be a particular problem if the government excludes MVAs and other investment deductions from its consideration of caps on exit fees.

*Voluntary approach*

The industry would only embrace a voluntary approach if it considered there was a competitive advantage to doing so. Consumers have no market power in this situation – they cannot choose a different provider with a lower exit fee, so there is no incentive on providers to change. Even if some firms decided to lower their headline fees, the risk is they would simply extract the lost fees and charges from elsewhere.

## Transfer process

**Question 11: What, in your view, is the scope for making the process for transfers more efficient through a standard approach that works for the majority of pension savers? Should this process focus on transfers in relation to flexible benefits? How might this work in practice?**

The FCA report[6] says that the transfer time for a majority of pension products is generally around 16 days. However, complex products could result in significantly higher transfer times (as much as 191 days). In addition, the IT supporting pension transfers can be complex, sometimes causing delays of three months, which means consumers

[6] https://www.fca.org.uk/news/pension-freedoms-data-collection-exercise-analysis-and-findings

could lose money in that time. One possible solution is for the government and regulator looking at standardising IT systems for transfers.

The Panel supports the idea that consumers should have the right to move between pension providers free of charge if their existing provider does not offer all decumulation options. However, in the FCA report, firms themselves have raised the risks in having a standardised approach and the need to weigh this against perceived risks to consumers. While this should not be an excuse for inaction, we would urge the government not to lose sight of essential protection in pursuing reduced transfer times.

## Financial advice

**Question 12: What has been the impact of the legal requirement to receive independent advice on the process for transferring pensions with safeguarded benefits?**

The legal requirement has caused some confusion, and is not necessarily serving consumers well, for example:

- Some provider firms are insisting that customers take financial advice when the legislation does not require it;
- Some adviser firms are refusing to provide advice to consumers, particularly those with 'small pots', because they are concerned about continuing liability; and
- Some consumers are demanding to transfer against the advice they have received. Some advisers will transact for the customer anyway (based on the FCA factsheet on insistent clients[7]), but many are refusing. Consumers may not understand that by becoming an "insistent client" they lose consumer protection rights and have no come-back if their decision subsequently puts them in a worse position.

**Question 13: How could the process for seeking advice in relation to safeguarded benefits be made quicker and smoother, and clearer for individuals, firms, and advisers?**

The FCA's policy statement on transfers[8] and the factsheet on insistent clients[9] provide clear and sufficient information for advisers, and should, in time, dispel industry concerns about continuing liabilities in providing advice.

People do not understand why they are required to take advice in relation to certain transactions, and this has caused confusion and even hostility. Pension Wise should explain clearly why regulated financial advice is required (i.e. the individual is giving up valuable assets by transferring and it is therefore in their interests to get help with such an important and complex decision). Pension Wise should then refer people who want DB transfers to the MAS directory, where they can find an adviser willing to transact the business.

Alternatively, a second tier of Pension Wise regulated advisers could provide a free service. This would ensure people do not need to pay for advice they may not need.

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[7] https://www.fca.org.uk/your-fca/documents/factsheets/factsheet-no-035
[8] https://www.fca.org.uk/your-fca/documents/policy-statements/ps1512-proposed-changes-to-our-pension-transfer-rules-feedback-on-cp157-and-final-rules
[9] https://www.fca.org.uk/your-fca/documents/factsheets/factsheet-no-035

However, this would most likely involve a public subsidy.

**Question 14: What evidence do you have of wider issues regarding the implementation of the pension flexibilities that need to be addressed?**

The Panel has a number of wider concerns, many of which were echoed in the Work and Pensions Select Committee's recent report[10] on pension freedoms advice and guidance:

- There does not appear to be an overall policy goal – the government has not spelled out how it will judge the success or otherwise of pensions freedoms from the consumer perspective. Choice should be not an end in itself when decades of wellbeing in later life are at stake.
- The government should undertake research to ascertain what people do with their pension pots once withdrawn in cash, to ensure the reforms are delivering good outcomes for consumers.
- The lack of concise, consistent and regular data coming from the Pension Wise service. The government should regularly publish management information on who is using the Pension Wise service, and how often. This should include the mean and median pension pots of those who accessed the service. In addition, the government should conduct an evaluation of what money is being used for if withdrawn through a UFPLS, as this would inform what support consumers need from Pension Wise.
- The service delivery partners (i.e. telephone and face-to-face) are not consistent in their delivery and in the expertise of the advisers. TPAS insists on five years' experience for Pension Wise advisers, Citizens' Advice accepts people with no pension experience. Whether a consumer accesses the service via telephone or face-to-face they are entitled to the same level of quality and expertise;
- Pension Wise should offer a holistic service which takes into account consumers' individual financial situation, including debt, eligibility for benefits and assets such as property.
- The website is currently not suitable as a Pension Wise session as it does not go into enough detail;
- Recent figures published by the Association of British Insurers[11] shows that shopping around for annuities and for income drawdown has not increased. Reasons why consumers are choosing to stay with their existing provider need to be urgently investigated;
- Providers are not making consumers aware of the impact of costs and charges on their funds where they choose to remain invested; and
- The design of pension accumulation defaults in a world where there is no target retirement date, and pension benefits may be taken any time in the space of 10 years or more.

[10] http://www.publications.parliament.uk/pa/cm201516/cmselect/cmworpen/371/37102.html
[11] https://www.abi.org.uk/News/News-releases/2015/09/Payments-made-to-savers-since-the-pension-reforms-reach-nearly-2-5-billion-ABI-stats-show