Financial Conduct Authority

Final rules for charges in workplace personal pension schemes and feedback on CP14/24

March 2015

Policy Statement

PS15/5

Contents

In this Policy Statement we report on the main issues arising from Consultation Paper 14/24 *Charges in workplace personal pension schemes* and publish the final rules.

Please send any comments or enquiries to:

Roy Bartholomew
Life and Pensions Policy
Policy, Risk and Research Division
Financial Conduct Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Telephone: 020 7066 1708
Email: cp14-24@fca.org.uk

All our publications are available to download from www.fca.org.uk. If you would like to receive this paper in an alternative format, please call 020 706 60790 or email publications_graphics @fca.org.uk or write to Editorial and Digital Department, Financial Conduct Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS

Abbreviations used in this paper

ABI	Association of British Insurers
AMD	active member discount
AUM	assets under management
CBA	cost benefit analysis
DWP	Department for Work and Pensions
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
GAA	governance advisory arrangement
GPP	group personal pension
ICAEW	Institute of Chartered Accountants in England and Wales
IGC	independent governance committee
MiFID II	Markets in Financial Instruments Directive II
MIR	market investigation reference
NEST	National Employment Savings Trust
OFT	Office of Fair Trading
PRA	Prudential Regulation Authority
PRIIPs	Packaged Retail and Insurance-based Investment Products Directive
RAO	Financial Services and Markets Act 2000 (Regulated Activities) Order 2001
SIPP	self-invested personal pension scheme
TPR	The Pensions Regulator
WPC	with-profits committee

1. Overview

Introduction

1.1 We are publishing our rules to introduce the following measures in qualifying workplace personal pension schemes:

- A cap on the charges within default funds equivalent to 0.75% per year of funds under management from 6 April 2015.
- Preventing firms from paying or receiving consultancy charges[1] from 6 April 2015.
- Preventing firms from paying commission or other charges for advice that are not initiated by scheme members from 6 April 2016.
- Preventing firms from using differential charges based on whether the member is currently contributing or not from 6 April 2016.

1.2 Our new rules implement these measures for the firms that we regulate, relating mainly to contract-based workplace pension schemes (or 'contract-based schemes' as referred to in this paper). The Department for Work and Pensions (DWP) has consulted on aligned measures for occupational (commonly trust-based) schemes for which The Pensions Regulator (TPR) will be responsible (or 'trust-based schemes' in this paper).

Who does this affect?

1.3 This policy statement affects firms operating workplace personal pension schemes. Workplace personal pension schemes include personal pension schemes and stakeholder pension schemes ('personal pension schemes' in this paper) that employers make available to their employees.

1.4 In 2012, our data indicated that there were over 20 firms or groups that sold workplace personal pension schemes to employers in the UK. In addition, there are a number of other firms or groups that operate group pension schemes that are no longer being actively marketed

1 Consultancy charges (essentially, charges for advice given or services provided on group personal pension or stakeholder schemes by firms or intermediaries, as agreed between the employer and the firm or intermediary but paid for by employees without their express agreement) were banned in occupational and personal pension schemes by the Occupational and Personal Pension Schemes (Automatic Enrolment)(Amendment) Regulations 2013, effective as of May 2013. The FCA rules will complement this ban in respect of agreements entered into between the end of 2012 and May 2013.

to employers. Our proposed rules will also affect a number of these schemes. These measures apply to qualifying schemes[2] only.

1.5 This policy statement is also likely to interest:

- employers and their advisers in relation to the selection and ongoing monitoring of workplace personal pension schemes, and
- fund managers and other third parties providing services to firms operating workplace personal pension schemes

Is this of interest to consumers?

1.6 The charge cap and bans on certain charging practices are intended to act in the interests of relevant scheme members by restricting the charges they pay in workplace personal pension schemes. Therefore, this policy statement will interest consumers who are scheme members of workplace personal pension schemes, including employees who are actively contributing, employees who have previously contributed and former employees. It is also likely to interest consumer groups seeking better value for money for consumers with workplace personal pensions.

Context

1.7 The UK has an ageing population, with many people not saving enough for their retirement.[3] Automatic enrolment of employees into workplace pension schemes began in July 2012, with full rollout starting in October 2012, as part of the government's policy response to this challenge. By 2018, when staging dates for automatic enrolment (the dates from when automatic enrolment duties come into force for businesses) have all been passed, it is estimated that between eight and nine million people will be newly saving, or saving more, in a workplace pension scheme.[4] Many of these will not have made any active choice about how their pension savings are invested.

1.8 Automatic enrolment and the lack of policyholder engagement means that it is even more important to ensure that workplace pension schemes deliver the best possible value for money. However, the Office of Fair Trading (OFT) market study[5] in 2013 highlighted problems with the existing market, including poor outcomes for the buyer and the potential for conflicts of interest.

2 A *qualifying scheme* is defined in our proposed rules as "a *personal pension scheme* or *stakeholder pension scheme*, which provides money purchase benefits, used by an employer or employers to comply with duties imposed in Part 1, Chapter 1 of the Pensions Act 2008, which are in summary, to take necessary steps in relation to particular employees, by a particular time, to make those employees members of a pension scheme which meets the criteria set out in that Act and in regulations made under that Act".

3 www.pensionspolicyinstitute.org.uk/publications/reports/what-level-of-pension-contribution-is-needed-to-obtain-an-adequate-retirement-income

4 *Transparency data – DWP business plan transparency measures*, July 2014, DWP www.gov.uk/government/publications/dwp-business-plan-transparency-measures/dwp-business-plan-transparency-measures#number-of-employees-in-a-pension-scheme-sponsored-by-their-employer

5 *Defined contribution workplace pension market study* - http://webarchive.nationalarchives.gov.uk/20131101164215/www.oft.gov.uk/OFTwork/markets-work/pension

1.9 In its report[6], published in September 2013, the OFT found that the market for buyers was 'one of the weakest that the OFT has analysed in recent years'. Employers make most of the key decisions but may lack the capability and/or the incentive to ensure that members of their schemes receive value for money in the long term. Employees often take little interest in their pension savings and, with automatic enrolment, they make no active choice to join, are enrolled at a default contribution level, and do not need to choose the fund into which they save. Neither employers nor employees can therefore currently be expected to drive effective competition between firms.

1.10 The weaknesses identified by the OFT may result in poor value for money in workplace pension schemes and/or funds, or them becoming poor value for money over time. As a result, the government is introducing measures to protect members of workplace schemes by tackling high and unfair charges and raising standards in scheme governance. The Department for Work and Pensions (DWP), The Pensions Regulator (TPR) and the FCA have worked closely together in developing the rules necessary to ensure these measures meet government policy objectives to protect members from poor value for money in workplace pension schemes.

1.11 The FCA is making rules to implement the charge cap and bans on consultancy charges, differential charges and commission for workplace group personal pensions we regulate. DWP regulations will impose similar requirements for occupational schemes regulated by TPR.[7]

1.12 In our consultation paper[8], published 30 October 2014, we set out our proposed rules. These required firms that operate workplace personal pension schemes used for automatic enrolment to implement a charge cap within the default funds of those schemes. The proposed rules also introduce new measures to stop providers using differential charges (in particular Active Member Discounts or AMDs) based on contribution status in workplace personal pension schemes. They also prevent providers from paying commission and other remuneration to advisers in relation to services not initiated by scheme members.

1.13 Our consultation closed on 30 December 2014. We have considered the comments and feedback received in finalising our new rules to implement these measures.

1.14 In this policy statement, we are publishing our new rules to implement the charge cap and bans on certain charging practices in workplace personal pension schemes as described in 1.12. We consider that our new rules advance the following statutory objective of the FCA:

- Securing an appropriate degree of protection for consumers: a charge cap and the other measures to be implemented will protect the interests of relevant members of workplace pension schemes by restricting the levels of charges that providers can levy. In conjunction with other changes being implemented, such as the development of independent governance committees (IGCs) consulted on in CP14/16, they will promote better value for money.

1.15 Our new rules and the DWP's new regulations are aligned to ensure similar expectations for contract and trust-based workplace pension schemes.

6 *Defined contribution workplace pension market study –* http://webarchive.nationalarchives.gov.uk/20131101164215/http:/www.oft.gov.uk/OFTwork/markets-work/pensions/

7 www.gov.uk/government/consultations/better-workplace-pensions-putting-savers-interests-first

8 *Charges in workplace pension schemes, 30 October 2014, FCA* www.fca.org.uk/news/cp14-24-charges-in-workplace-personal-pension-schemes

Cost benefit analysis

1.16 The final rules set out in Appendix 1 to this policy statement do not differ significantly from the draft rules on which we consulted in our consultation paper. The cost benefit analysis published in Annex 1 of our consultation paper therefore remains unchanged.

Compatibility Statement

1.17 The final rules set out in Appendix 1 to this policy statement do not differ significantly from the draft rules on which we consulted in our consultation paper. We therefore consider that the statement of compatibility with our objectives and general duties published in Annex 2 of our consultation paper remains valid.

Summary of feedback and our response

1.18 We received 31 responses to our consultation from a variety of stakeholders, including consumer groups, trade bodies, firms and political bodies.

1.19 We are grateful for the feedback received and want to take this opportunity to thank all those who responded to our consultation. We have considered carefully the responses that we received before deciding on our policy approach and final rules.

1.20 Respondents were generally positive about our proposals. The main concern was the challenge of delivering the changes necessary to ensure compliance within the required timescales. We are not recommending any significant changes to the rules as proposed in the consultation paper.

1.21 The following table provides an overview of the feedback received and our response to that feedback.

Feedback received	Our policy response
Virtually all respondents agreed that workplace personal pension providers are best placed to ensure compliance with the charge cap. The key concern was whether providers would be able to identify that a pension was being used by an employer for automatic enrolment purposes.	Under S. 26 Pension Act 2008, employers are obliged to enter into a specific agreement with the provider (as is the provider with the jobholder) to comply with automatic enrolment requirements. In our view, in most cases this agreement should be sufficient for providers to know that a scheme is a Qualifying Scheme. Where such an agreement is not in place, we expect firms to be pro-active in checking with employers whether the employer intends to use the scheme as a Qualifying Scheme to meet their obligation under Principle 6 to treat customers fairly.
There was a perceived risk that FCA rules might place a requirement on providers of qualifying workplace personal pensions to hold extra capital. This was perceived as a temporary issue under the Solvency I regime, which will fall away under Solvency II as of 1 January 2016.	Capital requirements are a matter for the PRA to determine when implementing the current EU Solvency I directives and (after 1 January 2016) the EU Solvency II regime. The PRA was consulted on CP 14/24 and explained that the introduction of the pension charge cap may lead to an increase in capital requirements for some firms owing to the minimum requirements of the current Solvency 1 directive. The PRA will assess cases on an individual firm basis. However, neither the FCA nor the PRA have a policy objective to increase current capital requirements for underwriting life expense risk. When Solvency II is implemented in 2016 firms may be able to take an approach to capital requirements that better reflects the nature of expense risk and which may help reduce the impact of any increase in capital experienced in the short term.

Some respondents expressed concern that the '80% test'[9] for deemed default funds in COBS rules would be ongoing, had no clear date of application and would include and thereby 'disturb' those who have made an active investment choice.	We have clarified that our policy intent aligns with that of the DWP, in that the proposed rules require the '80% test' to be calculated once and only in the absence of a clear default.
Nearly all respondents agreed that our proposed calculation measurement of average funds under management during the course of the year is the most appropriate method. There were some calls for flexibility over some measurements used (for example the use of reference points where units are priced daily and the potential need to allow for days when the markets were closed). Several respondents also raised concerns about applying the charge assessment calculation model to schemes that used a mixture of charging and rebating.	We have aligned with the DWP's policy intent on flexibility over the use of reference points where units are priced daily by clarifying that no amendment is desirable to address 'closed days' due to the added complications this may cause. Schemes using daily reference points should simply use the latest available valuation of funds under management for each day. Regarding the issues raised by schemes and systems using a mixture of charging and rebating, our proposed rules will align with DWP regulations 7 & 8. These allow for an additional mechanism for an alternative 'prospective' method of charge assessment. In any event, the calculation method is provided as an evidential provision in the rules, which means firms may use other methods as long as they can demonstrate compliance with the cap.
All respondents agreed that all members in Qualifying Schemes, not just in default funds for automatic enrolment, should be covered by the protections from differential charges (in particular Active Member Discounts or AMDs) under the proposed rules.	We will implement the ban on differential charges in Qualifying Schemes via our proposed rules as planned. We have also made clear that employers will not be prohibited from paying some or all of the charges on behalf of their current employees, as long as the overall charge level imposed on the members' funds is the same, irrespective of whether the member is contributing or not contributing.
Almost all respondents agreed that members' funds should only be used to pay for advice where the member has explicitly agreed to the services provided by the adviser. In the future, these should not be paid for via commissions from the provider that have ultimately been taken from the charges within the scheme.	We will implement the bans on consultancy charging and commission in Qualifying Schemes via our proposed rules as planned and consider and review the need for further guidance on adviser charging in the light of them.

Equality and diversity considerations

1.22 In CP14/24, we said that we had assessed the likely equality and diversity impacts of the proposed rules for the charge cap and bans on charging practices and did not think they give rise to any concerns. We considered that the proposed rules should ensure that the interests of potentially vulnerable members are represented and that concerns are raised on their behalf.

> ***Q1:*** ***We would welcome views on the likely equality and diversity impacts of the proposed rules.***

1.23 Nearly all respondents agreed that our proposed rules for the charge cap and bans on charging practices apply equally to all scheme members (except members who had ceased contributing prior to 6 April 2015, or their employer's staging date if later) and should not give rise to concern with regards to their likely equality and diversity impact.

1.24 A small number of respondents commented on the potential difficulty for ethical or religious funds (which it was felt commonly may have higher charges due to active management and research costs) to act as default funds under the charge cap as opposed to an active choice going forward. However, it is not apparent to us that these funds are widely used as default funds at present (ethical and religious convictions tending to be a matter of active choice in any event). Furthermore, the charge cap applies to all default funds equally without discrimination, therefore allowing these funds, if used as default funds, to be subject to higher charges than other default funds would in effect discriminate against them on the grounds of cost. As such, no further action on this is proposed.

Our response

We believe that members of workplace personal pension schemes will benefit from the protection of the charge cap and charging bans, regardless of whether they belong to a protected characteristic group. We do not consider that there is a need for any mitigating actions from an equality or diversity perspective. This position does not prevent individuals from choosing to switch to a higher charging fund if they wished to on ethical or religious grounds.

Next steps

1.25 The charge cap will apply from the later of:

- 6 April 2015
- the date from which a scheme becomes a Qualifying Scheme for an employer

1.26 This means that for automatic enrolment schemes already in operation before 6 April 2015, firms will be required to ensure compliance with the charge cap from this date onwards. For employers with a later staging date for auto-enrolment, the charge cap will apply from the date a scheme becomes a Qualifying Scheme for that employer.

1.27 Contributions to a default fund within a Qualifying Scheme will be protected by the charge cap, although contributions made prior to 6 April 2015 to a qualifying scheme will not be protected by the cap if the member ceases contributing prior to 6 April 2015.

1.28 On 6 April 2015, or the date on which the scheme became a Qualifying Scheme if later, a default arrangement will be assigned. The funds of any individual contributing to the default arrangement after this date will be subject to the charge cap. Where the employer or provider subsequently changes the default, e.g. new joiners start to be enrolled in a different fund, then the new fund will also be assigned as a default arrangement.[9]

1.29 Firms will be expected to comply with the charge cap from 6 April 2015 onwards.

1.30 The rules preventing firms from paying consultancy charges will also become effective from 6 April 2015. Firms will therefore be required to remove this feature from the small number of Qualifying Schemes still using consultancy charges by 6 April 2015.

1.31 The rules preventing differential charges will come into effect from 6 April 2016. The ban will apply to the schemes of any members who make a contribution while still working for their employer on or after 6 April 2016.

1.32 Our rules preventing payment of commission and the remaining banned remuneration payments, including all other mechanisms for members paying for services they have not initiated, will be introduced to Qualifying Schemes from 6 April 2016. Firms will therefore be required to remove these payments and mechanisms from Qualifying Schemes by 6 April 2016. They will be subject to the charge cap with effect from 6 April 2015 in any event.

What do you need to do next?

1.33 Firms affected by these changes will need to:

- ensure compliance with the charge cap from 6 April 2015 onwards
- remove consultancy charging from Qualifying Schemes by 6 April 2015
- amend any differential charges on the basis of contribution status in Qualifying Schemes by 6 April 2016
- remove commission and the remaining banned remuneration payments, including all other mechanisms for members paying for services they have not initiated, from Qualifying Schemes by 6 April 2016

What will we do?

1.34 The FCA will consider further with the DWP the need for additional reporting requirements to demonstrate compliance with the charge cap and bans set out in these rules. The DWP intends to review the level of the charge cap in 2017, to see whether it should be changed, and whether it should be extended to some or all transaction costs.

9 The first test applied to default funds(where the member's contributions are directed when they make no investment choice) is an ongoing test, whereas the "80% test" (see below) is a one-off test.

2.
Applying the charge cap to workplace pension schemes

2.1 In this chapter we summarise in more detail the feedback received on the proposed scope, operation and measurement of the charge cap, and considerations for provider firms in implementing it for workplace personal pension schemes.

Rules for firms providing workplace personal pension schemes

2.2 In CP14/24 we indicated that we had been working with the DWP to consider the most effective way to implement the charge cap. We proposed to introduce new rules on firms providing workplace personal pension schemes. Our proposals required firms to implement a charge cap in schemes that employers use to meet automatic enrolment requirements. Separately, the DWP would introduce new rules that required trustees of occupational schemes to implement a charge cap, where their schemes were used to meet automatic enrolment requirements, to ensure consistency across all qualifying schemes.

> ***Q2:*** ***Do you agree that workplace personal pension scheme providers are best placed to ensure compliance with the charge cap?***

2.3 Virtually all respondents agreed that workplace personal pension providers are best placed to ensure compliance with the charge cap.

2.4 Some respondents were concerned that there may be situations where the provider is unaware that a scheme is being used for auto-enrolment purposes. The Pensions Act 2008 provides that employers are required to have an agreement in place with providers to use a scheme as a qualifying scheme and have an obligation to advise that a scheme is being used for automatic enrolment. While in theory this should ensure that it is relatively straightforward to identify whether a scheme is being used for automatic enrolment, some providers have raised concerns that employers do not always tell them when a scheme is used for automatic enrolment.

2.5 As one respondent noted, for there to be a qualifying pension scheme, there must be an agreement in place between the employer and pension scheme provider, in addition to an agreement between the provider and the jobholder, with regard to the maintenance of minimum contributions (Section 26 Pensions Act 2008). They anticipated relying on the presence or absence of this agreement to determine whether a scheme is qualifying (in which case the cap applies), or not (in which case the scheme is not a Qualifying Scheme and the cap does not apply). They did not believe that the importance of this agreement is widely understood and had contacted TPR to raise awareness of its significance alongside paying the correct level of contributions. They felt it would be useful if the FCA recognised that, to be a Qualifying Scheme, the employer needs to have complied with all the requirements demanded by the legislation and only where they have complied with all the requirements will the scheme be qualifying and therefore subject to the charge cap.

2.6 A small number of respondents indicated that further clarity was required regarding the duty of providers to comply with provisioning and capital requirements in relation to the charge cap.

2.7 One respondent had significant concerns that certain phrases in the FCA CP and draft regulations might go beyond the policy intentions. In doing so, there was a perceived risk that FCA rules might place a requirement on providers of qualifying workplace personal pensions to hold extra capital. This was because (in their view) the PRA might interpret the drafting as meaning providers must guarantee to continue to operate a workplace pension for a particular employer within a charge cap and be unable to increase charges (above the cap) at any future point in time. This was perceived as a temporary issue under the Solvency I regime which fell away under Solvency II as of 1 January 2016. (See Proportionality section below).

Our response

We recognise that, for there to be a qualifying pension scheme, there must be an agreement in place between the employer and pension scheme provider, as well as between the provider and the jobholder, with regard to the maintenance of minimum contributions (Section 26 Pensions Act 2008). We flagged this originally in paragraph 2.42 of CP14/24 (see also comments on considerations for firms implementing the charge cap below).

Our rules require firms to ensure compliance with the charge cap, but we recognise that the employer also needs to have complied with all the requirements demanded by the legislation. Only where they have complied with all the requirements will the scheme be qualifying for the purposes of automatic enrolment and therefore subject to the charge cap.

However, where the situation is unclear, firms remain under the Principle 6 obligation to treat their customers fairly. We have made it clear to provider firms that we expect them to engage early and proactively with employers where they have not been informed whether schemes are being used for automatic enrolment. We therefore do not propose any changes to our rules in the light of these responses.

Capital requirements are a matter for the PRA to determine when implementing the current EU Solvency I directives and (after 1 January 2016) the EU Solvency II regime. The PRA was consulted on CP 14/24 and explained that the introduction of the pension charge cap may lead to an increase in capital requirements for some firms owing to the minimum requirements of the current Solvency 1 directive. The PRA will assess cases on an individual firm basis. However, neither the FCA nor the PRA have a policy objective to increase current capital requirements for underwriting life expense risk. When Solvency II is implemented in 2016 firms may be able to take an approach to capital requirements that better reflects the nature of expense risk and which may help reduce the impact of any increase in capital experienced in the short term.

Scope, level, start date and methodology for deeming default options relating to the charge cap

2.8 In CP14/24 we proposed the charge cap would apply to personal pension schemes and stakeholder pension schemes (in this document collectively referred to as 'personal pension schemes') used by employers as Qualifying Schemes for the purposes of automatic enrolment. To align with DWP draft regulations, there are two exemptions - one for non-money purchase benefits offered by schemes[10] and another for defaults which offer a third party promise.[11]

2.9 We outlined the government's intention for the charge cap to be equivalent to 0.75% per year of funds under management. The charge cap would apply to both new contributions and existing monies held within default investment arrangements from the date of its application.

2.10 We proposed to allow firms to use two alternative types of charges – contributions charges and flat rate fees – which could be used in combination with a charge based on funds under management. No other combinations would be permitted in default arrangements. The proposed maximum amounts that could be charged each year when these alternate charging structures were used were demonstrated in a table in our proposed rules aligned to that in proposed DWP regulations.

2.11 We proposed that the level of the charge cap should remain equal across both occupational pension schemes and personal pension schemes, so that members of workplace pension schemes receive the same protections under the charge cap regardless of scheme type.

2.12 The DWP would have the power to vary the charge cap in future. It is our intention that FCA rules should continue to align with any such variation applied to occupational pension schemes made by the DWP, to ensure consistency is maintained across both types of scheme. In addition, Independent Governance Committees (IGCs) will be tasked with monitoring providers' levels of costs and charges in relation to overall value for money (and so monitoring firms' compliance with the charge cap).

2.13 We proposed the charge cap should apply from the later of:

- 6 April 2015
- the date from which a scheme becomes a Qualifying Scheme for an employer

2.14 For those employers who were already subject to the automatic enrolment requirements before 6 April 2015, firms would be required to ensure compliance with the charge cap from this date onwards. For employers with a later staging date for auto-enrolment, the charge cap would apply from the date a scheme becomes a Qualifying Scheme for that employer.

2.15 All contributions made on or after 6 April 2015 to a default fund within a Qualifying Scheme would be protected by the charge cap. All the funds of any individual contributing to the default arrangement on or after 6 April 2015, or the date on which the scheme became a Qualifying Scheme if later (on which date a default arrangement would be assigned), would be subject to the charge cap.

2.16 We also proposed a methodology for deeming funds as the default option in cases where schemes may not have had a default investment option before automatic enrolment. We

10 excluded from all the charges measures, through the FCA definition of a qualifying scheme

11 excluded from the charge cap via rule COBS 19.6.2.R

proposed that, in such cases, firms would be required to deem whether the investment options members are in should be treated as default funds. The default fund is determined at employer level, so employers using the same provider may often have a different default. In determining whether an investment option should be deemed a default fund for a given employer's scheme, we would expect firms to consider:

- whether there was a clear default option
- whether members were required to make a choice from a range of alternative investment choices, and if so, whether 80% or more of contributing members in the Qualifying Scheme made the same investment choice

2.17 We proposed that firms, having reviewed the considerations above, should determine whether members had exercised a truly active and informed investment choice. Where no active choice had been exercised, a member's investment choice should be deemed to be a default investment option and, subsequently, the charge cap should apply.

2.18 We clarified that in cases where members may have chosen to invest in what is or would otherwise be deemed to be a default investment option because it is a default fund for other employees of that employer, the charge cap should also apply. We also made clear that firms may also choose to operate non-default funds within this charge structure.

> ***Q3:*** ***Do you think our proposed methodology for deeming default funds appropriately captures members who have not made active investment choices?***

2.19 Most respondents agreed that our proposed methodology for deeming funds as the default option appropriately captured members who have not made active investment choices. Several respondents, while recognising the intention to align FCA rules with the equivalent DWP provisions for occupational schemes, were concerned that:

1. The definition of default arrangement should be the same for both trust-based and contract-based schemes.
2. The 80% test in COBS rules[12] would be ongoing, had no clear date of application and would include and thereby 'disturb' those who have made an active investment choice.
3. The requirement to determine whether members had made an 'active and informed' investment choice was onerous for providers to ascertain and went beyond the 80% test.

12 Under the '80% test', where no default arrangement is expressly provided, an arrangement where, in relation to members who are employees of the same employer, at least 80% of those members of the qualifying scheme have their workplace pensions contributions invested, is deemed to be a default arrangement.

Our response

In response to the concerns at 1.- 3. above:

1. We have discussed our definition of default arrangements with the DWP and are both satisfied that our definitions are broadly consistent.

2. The proposed rules require the 80% test to be calculated once and only in the absence of a clear default.[13]

3. The proposed rules will require that the calculation should apply on 6 April 2015 or the staging date if later and except in the circumstances described at 2.18. will have no impact on those who have made an active choice.

We do not believe that these responses necessitate any substantial changes to the proposed rules.

2.20 Respondents felt that the charge cap should not apply to single member schemes, but commented that the term "executive pension scheme" in our proposed rules was not a concept that applied to contract-based schemes.

Our response

Having discussed this issue with the DWP, we have made appropriate minor amendments to the existing rule wording to align with their intention to remove certain single member schemes from the charge cap.

2.21 Some respondents noted that DWP regulations proposed to provide an 'adjustment measure' to grant trustees additional time to ensure compliance with the charge cap and to cater for unexpected events. They believed that it would be proportionate to permit similar measures for providers in contract-based schemes, particularly to bring a scheme back into compliance in the event of an exceptional or unexpected event.

Our response

Having discussed this issue with the DWP, the proposed regulation 10 (2) (b) provides an adjustment mechanism for trustees of occupational schemes only in limited and exceptional circumstances to take action (usually) to close a scheme and divert contributions to a compliant arrangement where the scheme subsequently proves to be not compliant following the introduction of the cap. As this measure is only intended to apply to trustees of occupational schemes in limited circumstances, it is therefore not appropriate to make it more widely applicable to providers of workplace personal pensions. Therefore we do not propose further rule changes in this respect.

13 As noted above, the first test applied to default funds (where the members' contributions are directed when they make no other choice) is an ongoing test, whereas the "80% test" is a one-off test.

2.22 One respondent expressed concern regarding the operation of default arrangements under the proposed rules where the pension scheme operator (for example, a Group SIPP operator holding the pension assets on a platform) did not set all the charges on the default arrangement, due to the use of external fund managers. The operator might choose a default fund that is within the charge cap and, at a later date, the fund manager might increase the charges on the fund so that it was above the cap.

2.23 In their view, if this situation arose, under COBS 19.6.2.R in the proposed rules the operator might be in breach of proposed rule COBS 19.6.5R due to the actions of the fund manager and may not be able to take any action to rectify this. The operator could lower the charge it had control over, the platform charge, to return to a 0.75% total. However in their view, under the platform rules in COBS 6.1E, platform charges could not be varied inappropriately according to the provider or for substitutable and competing retail investment products.

2.24 The respondent did not believe that materially reducing the platform charge for certain funds was an appropriate variation, meaning that to comply with the new COBS 19 rules, the operator would be likely to breach COBS 6. While it was possible that the operator could seek to convert to a lower-cost share class, if the fund manager had decided to increase its charges, it was unlikely to have a lower-cost share class or facilitate a conversion into one. The operator might otherwise switch members into a new arrangement, unless they had contacted members and gained express consent to remain within an existing arrangement. However in their view any such redirection of contributions into a new default arrangement raised questions as to whether they needed additional permissions or would be responsible for suitability or underperformance of the new investment.

Our response

We have made the policy intention clearer by removing the previous wording under COBS 19.6.2. and putting equivalent wording to DWP regulations into our definition of default arrangement.

We wish to make clear that operators using external fund managers for default arrangements as above are responsible for ensuring compliance with the charge cap overall under the proposed COBS 19 rules, which may entail taking any of the measures suggested above. We do not believe this would conflict with or breach the COBS 6 rules.

Our rules do not specify the type of fee a platform can charge. The charges should not vary inappropriately according to provider or, for substitutable and competing retail investment products, the type of product. However, the fee can be a fixed fee or a percentage, or a combination of these. It can also be set at different levels, for example, to distinguish between different service levels or different investment levels (e.g. a lower fee for higher investment amounts). So it is a commercial decision for the platform to decide what its charging structure should be, and the fees can vary if the variation reflects a difference in the level of service or administration involved or the amount the investor has with the platform.

Measuring charges against the cap

2.25 In CP14/24 we proposed that the charge cap will operate at a member level and firms will therefore need to ensure compliance with the charge cap for each member to whom it applies across the default arrangement as a whole.

2.26 Firms would not be expected to carry out individual calculations on a member-by-member basis to assess against the charge cap, but we would expect sufficient levels of monitoring and controls to provide certainty that the charge cap is not exceeded for any member. For combination charges, each member should be subject to a permitted charge as outlined in the table in our proposed rules aligned to that in proposed DWP regulations.

2.27 We proposed that firms should be able to assess the cap over a period of up to one year. Firms will be able to choose the end of the period to coincide with any existing annual processes. To enable firms to align the measurement period to suit their other business processes, we proposed to allow use of an initial measurement period of up to 18 months from April 2015. Thereafter, assessments will need to be carried out at least annually.

2.28 Where firms chose to adopt a measurement period that is not a year, we proposed that the limits must be pro-rated from the annual limits. We also proposed that, where members exited a scheme during an annual measurement period, the assessment of the charges they pay should be made against a pro-rated charge cap reflecting their shorter period of membership.

> ***Q4:*** ***Do you believe our proposals in relation to the period over which charges will be measured against the cap allow sufficient flexibility?***

2.29 Most respondents believed that our proposals in relation to the period over which charges will be measured against the cap are proportionate. Nearly all respondents agreed that our proposed calculation measurement of average funds under management during the course of the year is the most appropriate method.

2.30 Some respondents queried whether the policy intention of a proposed first assessment period of up to 18 months was in fact reflected in the draft evidential provision in COBS 19.6.9.E. One respondent queried whether the evidential provisions in COBS 19.6.9.E reflected the policy intention not to expect firms to carry out individual calculations on a member-by-member basis.

Our response

We have considered the evidential provisions in COBS 19.6.9.E in relation to our policy intentions:

1. of a proposed first assessment period of up to 18 months, and
2. not to expect firms to carry out individual calculations on a member-by-member basis

On 1) we have made a minor amendment to the rule to ensure that the policy intention is reflected accurately. On 2) we reiterate that the policy intention is that we do not expect firms to carry out individual calculations on a member-by-member basis, but do not see a need to amend the proposed rules to reflect this further.

Fund valuation

2.31 We identified that it will be necessary for firms to attribute a fund value on an annual basis in order to assess charges based on funds under management. We therefore propose that the fund valuation should be based on the average value over the course of the year. We also proposed that the average should be calculated using at least four reference points spread evenly across the year, e.g. daily, monthly, quarterly.

2.32 The rationale behind applying reference points throughout the year was that this would help to ensure that the charge cap is representative of members' fund values throughout the course of the year and not at just one point in time, e.g. end of year when the value could be at its highest. We considered this would provide a fairer solution for consumers.

> ***Q5: Do you agree that our proposed calculation measurement of average funds under management during the course of the year is the most appropriate method? If not, what would be a fairer solution for customers?***

2.33 Nearly all respondents agreed that our proposed calculation measurement of average funds under management during the course of the year is the most appropriate method.

2.34 Comments received from respondents on the most effective model of relevant reference points for measurement varied from annually through quarterly to a mixture of daily deductions and monthly rebating. These tended to be firm-specific rather than of general application. This bears out the potential difficulties of a 'one size fits all' approach to measurement.

2.35 One respondent noted potential issues with the use of reference points where units are priced daily. These arose because daily pricing did not involve equal intervals given weekends and other days when the markets are closed and there would be a need to include values on days when valuations were not done.

2.36 Several respondents raised concerns about applying the charge assessment calculation model to schemes that used a mixture of charging and rebating. The problems stem from using a system of higher daily charges, combined with monthly rebates. Such charging systems involved a daily charge of 1/365% for all schemes, with regular rebates to achieve different charge levels for different members. Respondents suggested that they are fair to members, but the way in which the rebate is paid means that these schemes, when nominally charging 0.75%, will in practice tend to fluctuate minimally around 0.75% and may inadvertently breach the cap.

Our response

The DWP clarified in its consultation response that no amendment to its regulations was desirable to address 'closed days', because different markets close on different days and some assets will vary in price over weekends; excluding 'closed days' from daily reference points would also necessitate changes to monthly or quarterly reference points when these fell on closed days. Therefore schemes using reference points where units are priced daily should simply use the latest available value of funds under management for each day. We agree with the DWP's view.

With regard to the issues presented by schemes and systems using a mixture of charging and rebating as above, our proposed rules will align with DWP regulations 7 & 8. These allow for an additional mechanism for an alternative 'prospective' method of charge assessment. In any event, the calculation method is provided as an evidential provision in the rules, which means firms may use other methods as long as they can demonstrate compliance with the cap.

In effect, where such schemes are not systematically biased against members, DWP regulations and our rules will allow that schemes may disregard changes in the valuation of the underlying assets within the charges year for the purpose of compliance. This is essentially because to comply via this method, firms will have to demonstrate that the charges and rebates involved offset each other over time. This does not enable firms to set charges in excess of 0.75%, but enables them to comply regardless of any minor fluctuations.

However, schemes that exhibit systematic bias against members, even in a small way, will still not be able to comply via this method. An example is a scheme that levies 1/365% on a daily basis, and then rebates one-twelfth of 0.25% at the end of each month, but does not apply a rebate for the final part-month's service when the member leaves mid-month. Such a scheme would not comply with the cap by the prospective method of assessment, because it would not meet the cap for any members who left mid-month.

Exclusions from the charge cap

2.37 In CP14/24 we proposed that the charge cap will apply to all charges and deductions made from members' pension funds with the following exceptions:

1. Transaction costs.
2. Where a member explicitly agrees to non-standard services being provided. In such cases, additional charges will be permissible if they are disclosed to the member as additional, discrete charges. In such cases the agreement needs to be in writing and contain an acknowledgement that the charges incurred may result in charges in excess of the charge cap. Also, such arrangements:
   - cannot be required as a condition of becoming or remaining a member of the scheme or fund
   - cannot apply to services that the provider is required by law to provide, and
   - cannot apply to core services
3. Charges incurred for the costs of complying with a court order, and
4. Costs incurred arising from earmarking orders or pension-sharing arrangements.

> ***Q6: Are there any other charges you believe should be excluded from the charge cap?***

2.38 Most respondents agreed with the proposed exclusions from the charge cap.

2.39 Some respondents argued that individual transaction costs should be fully listed in regulations and rules.

Our response

We share the DWP's view that, while arguably providing clarity for the industry, such an approach would not provide the necessary flexibility to update costs in the light of changing investment terminology and product innovation. This may therefore result in less certainty for providers over whether a particular cost or charges should be included in the cap. We do not propose to adopt this suggestion.

However, further work by DWP and FCA regarding the required disclosure of transaction costs by firms is ongoing. In addition, we have made clear[14] that Independent Governance Committees (IGCs) will need to consider all costs and charges, including transaction costs as part of their role in assessing value for money of schemes in future.

2.40 Some respondents suggested that the components of the Property Expense Ratio (PER, which covers a range of variable fund costs unique to funds with direct property holdings), should be included within the definition of transaction costs. A further query was raised as to whether or not a retained interest charge on a SIPP would fall within the definition of transaction costs.

Our response

The principle-based definition of transaction costs in our proposed rules (and the DWP's proposed regulations) applies to property funds as for any investment. Therefore those elements of the PER incurred as a result of buying, selling, lending and borrowing of the asset are transaction costs, whereas other costs such as marketing, insurance and property management would not fall within the definition and are subject to the cap.

The FCA's COBS rules (and the DWP's regulations) do not position a retained charge as a transaction cost, but as a direct charge in the same way as other direct charges.

2.41 One respondent argued that with-profits products containing guarantees and additional benefits should form a separate exclusion from the cap.

Our response

The DWP has implemented a 'carve out' in the regulations for the purpose of excluding products with underlying guarantees, the funding liability for which is borne by the scheme or by a third party. This is adequately reflected in our rules and we do not believe that further rule changes are necessary.

14 PS15/3 *Final rules for Independent Governance Committees, including feedback on CP 14/16* - www.fca.org.uk/static/documents/policy-statements/ps15-03.pdf

2.42 The same respondent queried the application of the charge cap to decumulation products in the light of the flexibilities announced in the 2014 Budget.

Our response

The DWP's policy intention[15] is that the charge cap will apply as long as the member's funds remain invested in the default arrangement. If transferring to a drawdown arrangement from which the pension flexibilities can be accessed, the transfer out would constitute a core service and be subject to the cap, but the costs of transferring into the drawdown arrangement and the ongoing charges of remaining in it would not be capped. The government has decided that, for the time being, drawdown should not constitute a core service. In view of this temporary position we do not intend to amend our proposed rules.

Government and regulators are monitoring the development of new retirement income products, including the next generation of drawdown products. We will monitor how the retirement income market develops and take action where appropriate if we see sources of consumer detriment arising or if competition is not working properly in the market.

Considerations for firms in implementing the charge cap

2.43 We made clear in the consultation that, where default funds within Qualifying Workplace Personal Pension Schemes do not currently comply with the charge cap, firms would need to take action to make them compliant. Where it was not commercially viable to offer the same product to policyholders within the charge cap, firms will need to agree with employers what actions to take. Options included:

- Making changes to schemes, e.g. the default fund is changed to a lower charging investment fund prior to the introduction of the charge cap.
- Firms no longer accepting contributions to schemes that will not comply with the charge cap and offering an alternative arrangement to the employer, prior to the later of:

  1. 6 April 2015 or
  2. the date on which the scheme becomes a Qualifying Scheme for an employer.

     In such circumstances the cap would only apply to investments in the new default arrangement, with past investments remaining in the previous scheme and subject to the previous charge rates (although IGCs will review the fairness of charges in both new and legacy schemes in future). If a firm decided to change the new default arrangement at a later date, however, the charge cap would continue to apply to the old arrangement, even if closed to new contributions.

- Advising employers to use another provider.

15 www.gov.uk/government/uploads/system/uploads/attachment_data/file/400864/better-workplace-pensions-putting-savers-interests-first-response.pdf

2.44 Where schemes with charges above the current cap provided additional features such as bonuses or additional benefits, we recognised that it may not be in the policyholder's interest to lose such features. In such cases, we would expect firms and employers to work together to find an appropriate solution, which (dependent upon policy terms and conditions and/or employers' and policyholders' willingness to pay on an opt-in basis may include:

- introducing a new default investment fund for existing members who have not previously made an active choice, but with the option of allowing members to make an active decision to remain in their existing investment fund with its benefits; or
- using another scheme as a Qualifying Scheme, but with members who have made an active decision and/or employers paying into a separate scheme to maintain the additional benefits

In either of these cases, the 80% test for default funds will not apply.

2.45 We also stated that providers offering a new default arrangement to consumers should also make it clear that they have the option of moving all of their invested funds into this new default and the implications of such a move, including any charges that might apply.

> *Q7:* ***Will clarifying the option of moving all their invested funds into a new default arrangement achieve the objective of moving customers to lower charging options where suitable? If not, what other measures could be taken to achieve this?***

2.46 Most respondents agreed that clarifying the option of moving all their invested funds into a new default arrangement would achieve the objective of moving consumers to lower charging options where suitable.

2.47 Most respondents agreed that the paper provided an initial framework by which to assess the considerations about whether to move a customer to a new default arrangement or leave them in their existing arrangement. In particular, considerations about the need to preserve the benefit of existing valuable guarantees; and whether or not additional charges for such benefits, agreed by the customer, were in the customer's best interest.

2.48 Some respondents preferred a positive affirmation process in customer communications – no response would mean that the customer would retain their existing investments in the existing fund to preserve existing benefits. Others preferred a negative affirmation allowing them to move customers to new default arrangements in the absence of a response. But at the same time they hoped for some form of 'regulatory override' for transferring clients to new funds based on information available at the time of the transfer to future proof against any future reviews.

2.49 Respondents wanting negative affirmation generally advocated some form of 'regulatory override' to sanction this, failing which an adequate audit trail of the rationale for any decisions taken would have to suffice.

Our response

Where schemes with charges above the cap provide additional features which it would not be in the policyholder's interest to lose without active consent, positive rather than negative affirmation is in line with the policy intention that consumers should only pay for services for which they expressly agree (see Chapter 4 below). We do not believe that a regulatory override is possible or justified given the number of complex situations that will vary by provider, scheme and nature of benefit and the value of the consequent loss of benefits to members. We expect robust and properly recorded assessment of all issues where customers might suffer loss of benefits, to ensure that firms have appropriately considered customers' best interests.

We recognise that in addition to placing future contributions into a new compliant default arrangement, firms may be considering the possibility of effecting bulk transfers of existing "legacy" personal pension benefits. We expect firms in all cases to comply with FCA rules and principles, in particular the obligation to treat their customers fairly[16]. Firms are also required to act in the clients' best interests[17] and to act consistently with the contracts which they have entered into. Otherwise, there remains a risk of legal challenge from customers who claim that the firm's unilateral action has put them at a disadvantage relative to the original contract. That said, there is no specific prohibition in our rules to bulk transfers of this type and this is not an entirely new consideration for firms.

We accept that bulk transfers can provide good outcomes in situations where scheme members are shown to benefit from such a transfer e.g. where the transfers result in lower charges. In the event that some customers could be made worse off by such a transfer, for example through the removal of certain guarantees, firms should consider the position of these customers and take appropriate action to ensure they are treated fairly. For example, this may include making available, and clearly communicating, alternative options to those customers (such as remaining in the original scheme).

In many cases, it may also be within firms' gift to reduce the level of charges within an existing structure without requiring a transfer.

16 Principle 6 of our Principles for Businesses requires a firm to pay due regard to the interests of its customers and treat them fairly.

17 COBS 2.1.1 (R) requires that a firm must act honestly, fairly and professionally in accordance with the best interests of its client

3.
The ban on differential charges

3.1 This chapter summarises feedback received on our proposed requirements on firms for banning differential charges in Qualifying Schemes based on the contribution status of the member, in particular Active Member Discounts (AMDs), and provides our response to that feedback.

Schemes to which the ban on differential charges will apply

3.2 Our proposed rules stop providers of workplace personal pensions taking actions that will increase member charges, based solely on whether a member continues to make contributions to the scheme. The ban on differential charging should apply to all members of personal pension schemes and stakeholder schemes used by employers as Qualifying Schemes, not just to default funds for automatic enrolment.

3.3 The ban will apply to the schemes of any members who make a contribution while still working for their employer on or after 6 April 2016.

3.4 We are not banning employers from paying some charges on their members' behalf.

Q8: ***Do you agree that all members in Qualifying Schemes should be covered by the protections from differential charges?***

3.5 All respondents agreed that all members in Qualifying Schemes, not just in default funds for automatic enrolment, should be covered by the protections from differential charges (in particular Active Member Discounts or AMDs) under the proposed rules.

Our response

In view of the responses received, we do not propose to make any amendments to the proposed rules.

Considerations for firms when removing differential charging structures

3.6 In CP14/24 we stated that, where providers have the ability to increase charges in the event of changes to regulations, we would expect them to calculate the terms they are able to offer on a single charging basis and implement the new charges structure on or before 6 April 2016. Where providers do not have the flexibility to amend the charges within existing schemes, we would expect them to inform employers that they will no longer be available to be used as a Qualifying Scheme. In such cases, providers may choose to offer an alternative scheme to the employer with a charging structure that is compliant.

3.7 We do not intend to prevent employers from choosing to subsidise existing employees, whether through pension contributions or in a contribution towards their charges. The key consideration is that the charges levied by the provider must not vary by contribution status and must be below the charge cap with effect from 6 April 2015.

> *Q9:* ***Do you think moving from differential charging structures, based on whether members are paying contributions, will create any major difficulties for firms or employers?***

3.8 Most respondents did not see ending the use of differential charging structures based on contribution status would create difficulties for firms or employers. A number saw communicating these changes as a major challenge, particularly where charges to active members were to increase as a result of changes.

3.9 A couple of respondents highlighted that currently Group Personal Pension (GPP) schemes often moved provider, with active members moving to a new provider with a reduced charge and deferred members staying with the existing provider. They felt that the proposed COBS 19.6.12.R wording may prohibit this in the future. It was noted that the intention was that employers should not use separate schemes for contributing and non-contributing members to facilitate circumvention of the charging rules but might at some point want to move active members to a new provider.

3.10 Some respondents requested clarification that there would be no objection if, provided all members are charged below the charge cap, the employer subsidised existing employees by means of extra contributions or by paying an administration fee to the provider. One respondent queried how a subsidy should be treated where there was no direct relationship between the flat fee per active member subsidy and the basis points (bps) differential in charges between the active and deferred members bps charge.

Our response

The intention that employers should not use separate schemes for contributing and non-contributing members to facilitate circumvention of the charging rules is clear. We recognise that employers may at some point want to move active members to a new provider. However, COBS 19.6.12.R does not prevent an employer (as opposed to a provider firm) moving active members to a new provider that may have lower charges. Therefore no change is proposed.

We do not intend that employers would be banned from paying some or all of the charges on behalf of their current employees. The test for providers is that the overall charge level they impose on the member's funds is the same irrespective of whether the member was contributing or not contributing. We are happy to align with this clarification.

It is still possible for employers to pay a flat fee to the provider in exchange for a lower annual management charge on active members. But the provider is responsible for the systems and controls to promote assurance that the level of subsidy is equal to the value of the reductions in annual management charges on active member funds. We would expect the provider to have sufficient controls in place to be able to demonstrate that this continued to be the case on at least an annual basis.

4.
Adviser remuneration, commission ban and consultancy charge ban

4.1 This chapter summarises feedback received on our proposed bans on commission and consultancy charging in Qualifying Schemes and related considerations regarding adviser remuneration and providing our response to that feedback.

Payment for advice and services by members following the commission and consultancy charge bans

4.2 In CP14/24 we outlined the government's intention for all Qualifying Schemes to be free of commission and consultancy charges. We also clearly stated that firms adopting alternative mechanisms (such as adviser charging) through which members effectively pay for advice to employers or for services they do not want or need, is not in line with the spirit of our proposed rules.

4.3 However, we accepted that there are benefits for members being able to use their pension funds to pay for advice in certain circumstances. Therefore we did not propose to ban payments from schemes to advisers completely. Instead, we proposed to require that any services provided to a member by an adviser can only be paid for from the member's fund where the member has expressly agreed that the advice be provided, thus helping to ensure that members only pay for services that they require.

Q10: Do you agree members' funds should only be used to pay for advice where the member has explicitly agreed to the services provided by the adviser?

4.4 Almost all respondents agreed that members' funds should only be used to pay for advice where the member has explicitly agreed to the services provided by the adviser and that, in future, these should not be paid for via commissions from the provider that have ultimately been taken from the charges within the scheme. Some respondents also indicated that they agreed with the point made at 2.40 of CP14/24 that membership of a scheme should not be conditional on such an agreement by a member.

4.5 Some respondents envisaged an 'advice gap' in future where members were unwilling, or unable, to agree to an adviser charge. They called for further guidance from the FCA on adviser charging, to clarify regulatory expectations and ensure that, for example, it is only used for specific advice to members and does not also cover employer costs that they may seek to recoup via this route rather than paying upfront costs. But if this situation arose, it would be addressed by our proposed ban on consultancy charges.

4.6 Further concerns were raised by some respondents regarding adviser 'services' provided to members via one-off fees to facilitate pension transfers of pension benefits to the employer's new scheme. The concerns were that these fees, if taken as a percentage of the value transferred, may not be as fair as flat fees, also that, regardless of the charging basis, they may fall outside HMRC guidance on charges for advice, resulting in significant tax charges for the member and the scheme.

Our response

We do not propose to make any changes to the proposed rules in the light of the comments received. It should be clear that members' funds should only be used to pay for advice where the member has explicitly agreed to the services provided by the adviser and then only on a basis that is fair and is not detrimental to members (for example, by failing to meet HMRC requirements). We will reflect further on the concerns raised above and note the tax issue and may consider and review the need for further clarification of our expectations in the light of actual experience of the operation of the bans on commission and consultancy charging.

The ban on consultancy charging

4.7 In CP14/24 we proposed rules preventing firms from being paid through consultancy charges that will become effective from 6 April 2015. We believe it is achievable for firms to remove this feature from schemes from 6 April 2015 as a result of the small remaining number of Qualifying Schemes using consultancy charges.

> ***Q11: Do you agree that it is achievable for firms to remove consultancy charges from Qualifying Schemes by 6 April 2015?***

4.8 Almost all respondents agreed that it was achievable for firms to remove consultancy charges from Qualifying Schemes by 6 April 2015, particularly in view of the small number of schemes remaining set up on this basis in the wake of the Retail Distribution Review (RDR)[18] and most were fully supportive.

4.9 Only one respondent envisaged the current deadline could cause difficulties, This was where, for example, an adviser was obliged under a fixed one year contract to provide a service financed by a consultancy charge. The adviser might then be left in a position where it was obliged to provide a service for a period but could no longer charge for it. The suggested solution was to implement the ban a year later, from 6 April 2016.

Our response

In our view the suggested solution (to implement the ban a year later, from 6 April 2016) would not resolve any difficulties but potentially prolong them. Most who responded on this point agreed that removing consultancy charges from Qualifying Schemes by 6 April 2015 was achievable. We therefore do not propose to make any changes to the proposed rules in the light of the comments received.

18 As noted above, consultancy charges were banned in occupational and personal pension schemes by the Occupational and Personal Pension Schemes (Automatic Enrolment)(Amendment) Regulations 2013, effective as of May 2013. The FCA rules will complement this ban in respect of agreements entered into between the end of 2012 and May 2013.

The ban on commission in Qualifying Schemes

4.10 We recognised that, due to the large number of schemes that were set up before the RDR incorporating commission payments, it was likely to take the industry longer to make the changes required to remove commission. Further, stopping payment of commission will impact on the incomes of the advisers who currently receive it.

4.11 We therefore proposed to allow firms a further year to remove from Qualifying Schemes all other mechanisms for members paying for services they have not initiated. Our rules preventing them will therefore be introduced from 6 April 2016.

> *Q12: **Do you agree commission and the remaining banned remuneration payments should be removed from Qualifying Schemes by 6 April 2016?***

4.12 Almost all respondents agreed that commission and the remaining banned remuneration payments should be removed from Qualifying Schemes by 6 April 2016, with several respondents expressing disappointment that this would not be achievable by 6 April 2015.

4.13 Perhaps unsurprisingly, adviser respondents expressed concern that turning off commission by 6 April 2016 would adversely affect the income streams of adviser firms. Provider respondents highlighted the cost to providers of terminating agreements and revising the charging structures for members to keep commission within the charge cap for a year until the ban took effect which, dependent upon the terms of their agreement, might lead to firms having to bear the cost of shortfalls.

4.14 One respondent sought clarification of our expectations for situations where initial/up-front commission payments have been made, and those payments are being reclaimed through charges. If the charges were within the cap, and the provider had not fully recovered the cost of making those up-front payments, in their view it would not be appropriate to reduce the member-borne charges on 6 April 2016. COBS 6.1D.6A will prohibit firms from 'offering and paying' commission in connection with a qualifying scheme, but in these situations the 'offer' would no longer apply, and the 'payment' would already have been made.

Our response

We note the concerns of adviser and provider firms, but based on the comments received, we do not proposed any changes to the proposed rules in this respect.

Member-borne deductions to cover the cost of paying initial commission can continue to be made providing the level of those deductions (when added to all other permitted deductions) is within the charge cap, and that no further ongoing payments will be made by the firm to the adviser.

However, where fund based commission is being paid, these payments will need to cease on 6 April 2016 and we would expect members to receive a corresponding saving.

5.
Proportionality of our overall approach

5.1 This chapter summarises feedback received on the proportionality of our overall approach in implementing the charge cap and charging bans, and provides our response to that feedback.

Proportionality

5.2 At the end of the cost benefit analysis in Annex 1 of the consultation paper, we asked whether respondents agreed that our proposed method of implementing the proposed changes was proportionate.

> ***Q13: Do you agree that our proposed method of implementing the proposed changes in line with government policy is proportionate?***

5.3 Nearly all those who responded broadly agreed that our approach was proportionate.

5.4 A couple of respondents went further and indicated that, with auto-enrolment bringing millions of new customers into pension saving for the first time, it was important that the proposed measures were enabled to create a framework that produced good consumer outcomes and promoted consumer confidence in workplace pension schemes. Some respondents indicated the need for both the DWP's and the FCA's regimes to align to achieve this across trust-based and contract-based schemes.

5.5 A small number of respondents indicated difficulty with commenting on proportionality without clarity on the potential capital provisioning implications in the changes in terms of any additional capital firms might be required to hold.

5.6 A number of respondents commented on the timing of the proposed changes by the government, the need to finalise the proposed rules very close to the date on which they will take effect and the need for a proportionate approach to their enforcement as a result.

Our response

We note the need for the DWP's regulations and the FCA's rules to align where possible to produce good consumer outcomes and promote consumer confidence in workplace pension schemes. We continue to work with the DWP to ensure that alignment is achieved while recognising any necessary areas of difference.

Capital provisioning is a matter for the PRA to determine within its remit against the current Solvency I regime and (after 1 January 2016) the Solvency II regime. The PRA has indicated that it would not respond formally to our consultation but will review such capital requirements on a supervisory case-by-case basis. It is not the FCA's (or the DWP's) policy intention that capital provisioning should be increased via the proposed rules and we have made this clear to the PRA. Following discussion with the PRA, we have made minor changes to the wording of our draft rules to reinforce this, without changing the substance of our proposals.

The DWP and the FCA have made clear that the timescale is driven by the need for both the DWP and the FCA to implement government policy in alignment and that, once approved, firms will need to ensure compliance with the proposed measures from 'day one' (6 April 2015) onwards. We will nonetheless continue to ensure that our regulatory approach remains proportionate to the risks identified.

Annex 1
List of non-confidential respondents

Aegon

Altus Ltd

aquilaheywood

Associations of British Insurers

Association of Accounting Technicians

Association of Member Nominated Trustees

Association of Pension Lawyers

Association of Professional Financial Advisers

Association of Professional Pension Trustees

B&CE, The Peoples's Pension

Capita Life and Pensions Regulated Services Limited

Charlton Frank Ltd

Eversheds LLP

Financial Services Consumer Panel

Friends Life Group

Hargreaves Lansdown

Hymans Robertson LLP

ILAG Limited

Investment Association

International Financial Data Services (UK) Ltd

Legal & General Assurance Society Ltd

Pensions Management Institute

Prudential plc

Royal London Group

Scottish Widows

St James's Place Group

Society of Pension Professionals

Standard Life plc

TISA

Zurich Assurance Ltd

Appendix 1
Made rules (legal instrument)

PERSONAL PENSION SCHEMES (RESTRICTIONS ON CHARGES) INSTRUMENT 2015

Powers exercised

A. The Financial Conduct Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (General rule-making power);
(2) section 137T (General supplementary powers);
(3) section 138C (Evidential provisions); and
(4) section 139A (Guidance).

B. The rule-making powers listed above are specified for the purpose of section 138G (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force as follows:

(1) Part 2 of Annex B to this instrument comes into force on 6 April 2016;
(2) the remainder of this instrument comes into force on 6 April 2015.

Amendments to the FCA Handbook

D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

E. The Conduct of Business sourcebook (COBS) is amended in accordance with Annex B to this instrument.

Citation

F. This instrument may be cited as the Personal Pension Schemes (Restrictions on Charges) Instrument 2015.

By order of the Board of the Financial Conduct Authority
26 February 2015

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical place. The text is not underlined.

accrued rights charge	a charge used by an *operator* for a *qualifying scheme* which is calculated solely by reference to the value of a member's rights accrued under a *qualifying scheme*. 'Rights' has the same meaning as in article 82 of the *Regulated Activities Order*, that is, the *specified investment* of rights under a *personal pension scheme* or a *stakeholder pension scheme*.
administration charge	any charge made which: (a) relates to the money purchase benefits accruing to a member of a *qualifying scheme* whose *workplace pension contributions* are invested by way of a *default arrangement*; and (b) is levied on: (i) any of that member's *workplace pension contributions*; or (ii) any income or capital gain arising from the investment of such *workplace pension contributions*; or (iii) the value of the member's rights, insofar as those rights involve money purchase benefits, under the scheme; and (c) is levied to meet the administrative expenses of the scheme, to pay commission or to be deployed in any other way that does not result in the provision of pension benefits for or in respect of such a member; but an *administration charge* does not include any charge made for costs: (d) incurred directly as a result of buying, selling, lending or borrowing investments; (e) incurred solely in providing benefits in respect of the death of such a member of a *qualifying scheme*; (f) in complying with a court order, where that order has provided that the *operator* may recover those costs; (g) arising from earmarking orders or pension sharing arrangements pursuant to regulations made under section 24 or 41 of the

	Welfare Reform and Pensions Act 1999.
combination charge structure	a charging structure used by an *operator* of a *qualifying scheme* which is solely a combination of: (a) an *accrued rights charge* and a *flat-fee charge*; or (b) an *accrued rights charge* and a *contribution percentage charge*.
contribution percentage charge	a charge used by an *operator* of a *qualifying scheme* which is calculated as a percentage of contributions made by, or on behalf of, a member of that *qualifying scheme* over a defined period of time.
default arrangement	(a) an arrangement expressly provided by an *operator* of a *qualifying scheme* for the purpose of investing the *workplace pension contributions* of employees who have expressed no choice in relation to the investment of such contributions; (b) where no such arrangement is expressly provided, an arrangement whereby, in relation to members who are employees of the same employer, at least 80% of those members of the *qualifying scheme*, whether they had expressed a choice or not prior to the *qualifying scheme* coming into being, have their *workplace pensions contributions* invested, is deemed to be a *default arrangement*; (c) but an arrangement will not be a *default arrangement* under (b) if, prior to a scheme becoming a *qualifying scheme*: (i) all members within that arrangement have been told that their *workplace pension contributions* will be invested in a new arrangement once the scheme becomes a *qualifying scheme*, unless they give express agreement for their contributions to continue to be invested in the original arrangement; (ii) any members who wish to remain in the original arrangement have given express agreement in writing, including an acknowledgement that continuing in the original arrangement might mean that charges are higher than the limits set out in *COBS* 19.6 (Restriction on charges in qualifying schemes); and (iii) any members who did not agree to remain in the original arrangement have had their *workplace pension contributions* invested in the new arrangement; (d) where an arrangement is a *default arrangement* by virtue of (a) and (b), it continues to be such an arrangement regardless of whether it continues to satisfy those paragraphs.

flat-fee charge	a charge used by an *operator* of a *qualifying scheme* which is a specified charge for a period of time and which is not calculated by reference to member's contributions or accrued rights.
qualifying scheme	(a) a *personal pension scheme* or *stakeholder pension scheme*, which provides money purchase benefits, used by an employer(s) to comply with duties imposed in Part 1, Chapter 1 of the Pensions Act 2008. In summary, these duties are to take necessary steps for particular employees, by a particular time, to make those employees members of a pension scheme which meets the criteria in that Act and in regulations made under that Act; (b) but such a scheme will not be a *qualifying scheme* if the only members of that scheme are directors or former directors of the same employer, including at least one third of the current directors of that employer.
workplace pension contributions	contributions made to a *qualifying scheme* by, or on behalf of, an employee who has become a member of that scheme, including transfers in from other schemes.

Annex B

Amendments to the Conduct of Business sourcebook (COBS)

In this Annex, underlining indicates new text and striking through indicates deleted text, unless otherwise stated.

Part 1: Comes into force 6 April 2015

6.1C Consultancy charging and remuneration

…

6.1C.5 R Except as specified in *COBS* 6.1C.5AR ~~and~~, *COBS* 6.1C.5BR and *COBS* 6.1C.5CR, a *firm* must:

…

…

6.1C.5C R In connection with a *qualifying* scheme, a *firm* may only solicit or accept *consultancy charges* from an *operator* of a *qualifying scheme* if the *operator* has confirmed that express agreement has been given by members of that scheme under *COBS* 19.6.4R.

In COBS 19 (Pensions supplementary provisions) insert the following new section after COBS 19.5. All the text is new and is not underlined.

19.6 Restriction on charges in qualifying schemes

Application

19.6.1 R This section applies to an *operator* of a *qualifying scheme*.

19.6.2 R The restrictions on *administration charges* in *COBS* 19.6.4R do not apply in relation to a *default arrangement* under which, at any time before benefits come into payment, those benefits accruing to the member involve, or involve an option to have, a promise by or to be obtained from a third party about the rate or amount of those benefits.

Express agreement

19.6.3 G (1) In this section, where express agreement is required by a *rule*, the *FCA* would expect *firms* to take active steps to obtain the informed, active consent of the affected member(s) of the *qualifying scheme*, and to have that consent in writing in a *durable medium*, capable of being produced or reproduced when requested by the *FCA*.

(2) The *FCA* does not consider the following to amount to express

agreement (this list is not exhaustive):

(a) a member receiving a communication stating that by becoming or continuing to be a member of the scheme, the member has agreed to a particular service;

(b) a member being invited to click on a box to opt-out through a website link.

Default arrangements: charging structures and restrictions

19.6.4 R A *firm*, for a *default arrangement* within a *qualifying scheme*, may only make, impose or otherwise facilitate payment of an *administrative charge* by way of an *accrued rights charge* or a *combination charge structure* where:

(1) the limits in *COBS* 19.6.6R are not exceeded; or

(2) the *firm* has obtained appropriate express agreement to exceed the limits and the following conditions are satisfied:

(a) the express agreement contains an acknowledgement by the member that the *administrative charge* for the service is likely to exceed the limits;

(b) giving such express agreement is not a condition of becoming or remaining a member of the *qualifying scheme*;

(c) express agreement has not been given for services which the *operator* must provide under the *regulatory system* or the general law, or which are core services.

19.6.5 G The effect of *COBS* 19.6.4R(2)(c) is that a *firm* may not seek express agreement from a member to charges in excess of the limits for services which are obligatory under law, or form part of the core operation of the scheme. Such core services include, for example, designing and implementing an investment strategy, investing contributions to the scheme (to the extent that this would incur *administrative charges*), holding investments relating to scheme members and transferring a member's accrued rights into or out of a *default arrangement*.

19.6.6 R The limits on *administration charges* are as follows:

(1) for a *qualifying scheme* which uses only an *accrued rights charge*, 0.75% of the value of those accrued rights;

(2) for a *qualifying scheme* which uses a *combination charge scheme*:

(a) for the *flat-fee charge* element, £25 annually;

(b) for the *contribution percentage charge* element, 2.5% of the contributions annually;

(c) for the associated *accrued rights charge*, the limits as set out in column 2 of the table in *COBS* 19.6.7R.

19.6.7 R This is the table referred to in *COBS* 19.6.6R.

Contribution percentage charge rate (%)	*Accrued rights charge rate (%)*
1 or lower	0.6
Higher than 1 but no higher than 2	0.5
Higher than 2 but no higher than 2.5	0.4

Flat-fee charge (£)	*Accrued rights charge rate (%)*
10 or less	0.6
More than 10 but no more than 20	0.5
More than 20 but no more than 25	0.4

Compliance with the restrictions on charges

19.6.8 E (1) To ensure that *administrative charges* are within the limits set out in *COBS* 19.6.6R:

(a) a *firm should calculate* the value of accrued rights in an *accrued rights charge* as the arithmetic mean over a 12-month period of membership of the *qualifying scheme*, using at least four evenly-distributed reference points over that period;

(b) a *firm* should calculate the value of contributions in a *contribution percentage charge* over a 12-month period of membership of the *qualifying scheme* of a member's *workplace pension contributions*;

(c) for members who have been members of the *qualifying scheme* for a period of less than 12 months, a *firm* should calculate *administrative charges* on a pro rata basis;

(d) the total *administration charges* imposed should not exceed the relevant restriction when measured over a 12-month period. However, where the *qualifying scheme* has been in operation for less than 12 months, and the *firm's* internal processes would involve assessment of *administration charges* before 12 months has elapsed, then for its initial assessment, the *firm* may use a period of up to 18 months.

(2) Contravention of (1) may be relied on as tending to establish contravention of *COBS* 19.6.4R(1).

Consultancy charges

19.6.9 R (1) A *firm* must not make or otherwise facilitate any payment to a third party for advice or services provided pursuant to any agreement made between that third party and an employer for whom the *firm* is operating a *qualifying scheme*, including *consultancy charges*, which would have the effect of reducing the value of the accrued rights of a member of that *qualifying scheme* to whom this section applies.

(2) The restriction in (1) does not apply where the *firm* has obtained express agreement from the relevant member to such a payment.

19.6.10 G *COBS* 19.6.9R complements *COBS* 6.1C.5CR and *COBS* 6.1D, which prevent a *firm* which gives advice or provides services within the meaning of those sections to an employer in relation to a *qualifying scheme* from soliciting or accepting *consultancy charges* in relation to those services. *COBS* 19.6.9R prevents the provider of the *qualifying scheme* from providing such payments and prevents such payments to other advisers who give advice or provide services to employers, such as solicitors and accountants.

Part 2: Comes into force 6 April 2016

Amend the following as shown.

2.3 Inducements

Interpretation

2.3.-1 R …

<u>2.3.-1A</u> <u>R</u> <u>This section does not apply to giving advice, or providing services, to an employer in connection with a *group personal pension scheme* or *group stakeholder pension scheme* where that scheme is a *qualifying scheme*.</u>

<u>2.3.-1B</u> <u>G</u> <u>The rules governing fees, commissions and non-monetary benefits which may be paid or provided in respect of *qualifying schemes* are found in *COBS* 19.6.</u>

…

6.1C Consultancy charging and remuneration

…

6.1C.5A R A *firm* and its *associates* may<u>, except in relation to a *qualifying scheme*</u>:

…

…

6.1D Product provider requirements relating to consultancy charging and remuneration

…

6.1D.4 R …

(2) ~~Paragraph~~ Except in connection with a *qualifying* scheme, paragraph (1)(a) does not prevent a *firm* from making a payment to a third party that has facilitated the payment of a *consultancy charge* from a *group personal pension scheme* or *group stakeholder pension scheme*, provided that that payment is only in respect of that facilitation.

…

…

6.1D.6A R A *firm* and its *associates* may, except in connection with a *qualifying scheme*:

…

…

19.6 Restriction on charges in pension schemes

…

~~Consultancy charges~~ Prohibition of payments to third parties from qualifying schemes

19.6.9 R (1) ~~A *firm* must not make or otherwise facilitate any payment to a third party for advice or services provided pursuant to any agreement made between that third party and an employer for whom the *firm* is operating a *qualifying scheme*, including *consultancy charges*, which would have the effect of reducing the value of the accrued rights of a member of that *qualifying scheme* to whom this section applies.~~ A *firm* must not make any *administrative charge*, or otherwise make or facilitate any payment or provide any non-monetary benefit, in respect of any service provided by a third party in connection with a *qualifying scheme* which would have the effect of decreasing the value of the accrued rights of any member of that scheme.

…

19.6.10 G ~~*COBS* 19.6.9R complements *COBS* 6.1C.5CR and *COBS* 6.1D, which prevent a *firm* which gives advice or provides services within the meaning of those sections to an employer in relation to a *qualifying scheme* from soliciting or accepting *consultancy charges* in relation to those services.~~

~~*COBS* 19.6.9R prevents the provider of the *qualifying scheme* from providing such payments and prevents such payments to other advisers who give advice or provide services to employers, such as solicitors and accountants.~~ [deleted]

Differential charges

19.6.11	R	A *firm* must not impose greater *administrative charges* on a member of a *qualifying scheme* whose *workplace pension contributions* ceased on or after 6 April 2016 than those imposed on a member for whom such contributions are still being made.
19.6.12	G	The effect of *COBS* 19.6.11R is to prohibit active member discounts within automatic enrolment schemes.

Financial Conduct Authority

PUB REF: 005022

25 The North Colonnade Canary Wharf
London E14 5HS
Telephone: +44 (0)20 7066 1000
Website: www.fca.org.uk