Chapter Seven

Stakeholder pension schemes

People on middle incomes want to save more for retirement but current pension arrangements are often unsuitable or expensive. Our new secure, flexible and value-for-money stakeholder pension schemes will help many more middle earners to save for a comfortable retirement.

1 **Chapter Six** described our proposals to replace the State Earnings Related Pension Scheme (SERPS) with the new State Second Pension. This will boost the second pensions of the lowest paid and give some additional help to those on modest earnings. Those earning below £9,000 a year are likely to be better off in the new State Second Pension. At higher earnings levels, however, we want to see an extension of funded pensions. Individuals who can save should do so. To achieve this, people need to understand the importance of saving for their retirement, and be confident they will benefit from anything they do save. Crucially, those who can save for their retirement need to have access to pension schemes that enable them to do so.

2 This country already has a well-developed framework of funded pensions. Occupational pension schemes sponsored by employers are one of the great welfare success stories. The growth of occupational provision is one of the main reasons for the improvement in pensioner incomes over recent decades. Nearly half of all current employees are in an occupational scheme. The market value of the funds held in occupational schemes is £640 billion. Personal pensions, and their predecessors, also hold an increasingly significant amount of retirement savings. The value of personal pension funds stands at about £190 billion.

3 Taken together, funded pension rights in the UK represent around 40 per cent of all pension rights. This balance of funded and unfunded provision is a key strength of the UK pension system. It is one of the reasons we face less severe public finance pressures than many other industrialised countries which are also experiencing an ageing of their population.

4 We are determined to build on this sound framework by supporting and strengthening funded pensions. The key to this is an effective partnership between the public and private sectors.

Stakeholder pension schemes

5 **Chapter Three** showed that not everyone can join a good second pension scheme. Occupational pension schemes continue to provide some of the best arrangements, reinforced by valuable contributions from employers. They are not an option for the 35 per cent of employees whose employers do not offer a scheme, nor for the self-employed.

6 Personal pensions do not always meet their needs. The costs of contacting potential customers and convincing them to take out a pension typically account for two-thirds of the total charges of personal pensions. These charges can cause a significant reduction in the value of a member's savings by the time they retire. Someone who has to stop contributing within a few years can often find they have lost most or all of their savings. Yet a third of the people who buy personal pensions cease contributing within three years.

7 Individuals can find personal pensions difficult to understand and nearly impossible to compare. Many are put off by the prospect of seeking financial advice; those who do can find it difficult to get impartial and cost effective advice. And mis-selling has tainted the whole sector.

8 We need to:

- **modernise the pension system to introduce more flexible, value-for-money, pension schemes;**
- **ensure people have confidence to entrust their savings to the schemes, in the knowledge that the schemes are secure and well-run;**
- **provide more efficient access to pensions; and**
- **promote the habit of saving, both in long-term pension schemes and through Individual Savings Accounts (ISAs), and provide the right flexibility between them.**

9 Our manifesto said we would create a framework for secure, flexible and value-for-money stakeholder pension schemes. We consulted widely on our proposals at the end of 1997. There was widespread agreement on the need for better value second pension schemes for those who cannot join occupational schemes. We have taken the consultation responses into account in developing these proposals.

Target group

10 Stakeholder pension schemes will be open to everyone. They are likely to be a cost-effective alternative to the new State Second Pension for those earning more than £9,000 a year. Those who earn above £20,000 a year are in most cases already making additional pension provision. But many people earning over £20,000 a year will be able, now and in the future, to take advantage of the lower charges, greater flexibility, and simpler tax regime which stakeholder pension schemes will introduce.

11 Around 10.75 million people – both employees and self-employed people – currently earn between £9,000 and £20,000 a year.

- **Half of these are in occupational schemes. Occupational pensions will usually be the best second pension option for that group. Our proposals to encourage take-up of occupational scheme membership will lead to an increase in the numbers in occupational schemes.**
- **About 5.3 million people are not in an occupational scheme. Of these, we estimate around 2.5 million contribute to a personal pension. Around 1 million people are in a personal pension but only pay in their National Insurance rebate and make no additional savings of their own.**

12 While stakeholder pension schemes will provide a better value option than most personal pensions, many people have already committed themselves to a personal pension. Under the terms of their contract, it may not be advisable for them to switch to a new arrangement. In the short term, we expect those who are not currently contributing to an occupational pension scheme or to a personal pension to be most likely to join. We will be looking to the personal pensions industry to facilitate transfer into stakeholder pension schemes where it is in the client's interest.

13 Those in today's workforce who are most likely to join stakeholder pension schemes are predominantly in full-time work. Nearly half work either in manufacturing or in the retail and hospitality industries. One in five are self-employed. Most will be under the age of 50. Roughly two-thirds are men and a third are women.

14 Over time, we can expect stakeholder pension schemes to cater for new generations of workers, including those on higher incomes who might otherwise have taken out personal pensions. Many people who have periods of part-time and lower paid employment will be likely to join stakeholder pension schemes when they are in full-time work. They will be able to continue making additional voluntary contributions to their stakeholder scheme even during periods when they are in the new State Second Pension.

Who would benefit from a stakeholder pension scheme?

- *25-year-old construction worker, self-employed, moving from site to site depending on where the work is.*

  His work is seasonal. He could afford to build up a good pension but he cannot find a scheme that offers the necessary flexibility to stop and start contributions. He cannot contribute to SERPS because he is self-employed.

- *30-year-old graduate working under contract for an independent TV production company.*

  She may stay in the same job for years, moving from one contract to the next, earning a decent wage. She has no access to an occupational scheme at present but believes she may join a company which offers a good occupational scheme and is worried she might lose out if she takes out an inflexible personal pension.

- *40-year-old chef, working for a restaurant chain.*

  He knows he should be building up a pension. His employer has suggested a group personal pension to him but will not contribute to it; he has heard about mis-selling and is worried about making the right choice.

- *35-year-old lone parent with one school-age child. Works through an agency as a temporary secretary.*

  She has changed jobs several times recently to fit in with her childcare arrangements. There is no occupational scheme on offer and she has never got around to finding out about a personal pension because she did not think it would be appropriate to her circumstances. She thinks she could afford to save around £10 a week into a pension and does not expect a financial adviser would be interested in people who can only save a small amount.

Outline of proposals

15 The features we propose for stakeholder pension schemes will work together to deliver a better deal for future generations of pensioners.

- **The costs of stakeholder pension schemes will be kept low, by:**
  - **using a collective structure, like occupational schemes, to get the best value-for-money for scheme members;**
  - **reducing the costs of marketing and collecting contributions, by ensuring access to schemes at the workplace;**

- **reducing the need for individual financial advice; and**
- **having simple tax rules.**

- **There will be minimum standards for charges and no penalties if people stop contributing, or choose to move to another arrangement.**
- **Members' rights will be secure and properly protected.**

16 The proposals set out here are designed to address four basic problems with the second pension options currently available to those who cannot join an occupational scheme. These are the:

- **complexity of personal pensions;**
- **difficulties individual buyers face in getting a good deal;**
- **costs of regulation; and**
- **costs of distributing and marketing pensions.**

17 **Firstly**, most current personal pensions are difficult products for people to understand. People find it hard to know whether a pension offers them a good deal and are unable to make easy comparisons between them. There are complex charging structures, with different types of charges and quite different effects depending on how long the pension is held for.

18 We believe this can be addressed for stakeholder pension schemes by defining a number of minimum standards which schemes must meet in order to be stakeholder pension schemes. These will promote standardisation across schemes, allowing consumers to compare what is on offer more easily. They will give a minimum level of protection and reassurance to potential scheme members that a stakeholder pension scheme will provide them with a good basic deal.

19 **Secondly**, individuals have limited power in the pension market. Personal pensions are complex. Individual consumers have no real power to negotiate with pension providers. Shopping around effectively is difficult. When they join, they have no influence on the terms of their contract and no power to press for improvements after they have joined. Pension providers similarly have little incentive to improve the contracts of existing members. A few members may move to other providers who offer a better deal, but most do not.

20 Stakeholder pension schemes need to be run with much greater emphasis on the interests of their members. They need to be able to use the buying power of the scheme members as a whole to get the best value-for-money, to improve the terms of the scheme and to go beyond the minimum standards set for all schemes. And they need to ensure that all scheme members receive a good service and that they all benefit from improvements to the scheme.

21 **Thirdly**, we need to address the costs of regulation. The regulation of personal pensions focuses on the way they are sold and the advice people receive. It is clearly right that people should get proper advice on significant financial investments like pensions. But advice has a cost.

22 We believe we can change the way we regulate stakeholder pension schemes, both to reduce the overall costs of regulation and to provide more security than the existing arrangements. We intend to move the focus of regulation from the sales process to the administration of the schemes. The reassurance provided by the minimum standards and by ensuring schemes are run in their members' interests will reduce the need for detailed financial advice when people join schemes.

23 **Fourthly**, personal pensions are expensive to distribute to potential customers.

24 We want to make access to stakeholder pension schemes as simple and cost-effective as possible. Two-thirds of employees are offered an occupational scheme by their employer. We will provide access to a pension scheme to the other third, at their place of work, by requiring employers to provide access to a stakeholder pension scheme and to pass on contributions from their employees' wages. Employers who already offer an occupational scheme to all their employees will not be affected.

Defining stakeholder pension schemes

25 A stakeholder pension scheme will have two key features. Firstly, stakeholder pension schemes will need to meet the minimum standards we shall set out for them.

26 Secondly, stakeholder pension schemes will need to be set up with an approved governance structure. The governance structure will need to ensure schemes are run in the interests of their members and are able to deliver an appropriate outcome in terms of value-for-money and service to the scheme members. We propose to legislate initially for one such model, where schemes are established under trust law and run by a board of trustees, but other structures may be approved later.

27 Stakeholder pension schemes will be required to register when they are set up. By registering, they will be undertaking to comply with these requirements, as well as all other conditions set for stakeholder pension schemes in relation to, for example, contracting-out and tax approval.

28 Most private sector occupational schemes are already set up under trust, with a controlling trustee board. It will therefore be open to occupational schemes which offer money purchase benefits to be designated as stakeholder pension schemes if they also meet the other requirements.

29 Although personal pensions are also often set up under a trust, the nature of the trust deed generally does not provide for the trustees to control the scheme. The personal pension provider retains overall control. Existing personal pensions will not therefore be able to describe themselves as stakeholder pension schemes.

30 Personal pensions will have the option to meet the minimum product standards for stakeholder pension schemes and to describe themselves accordingly in their promotional material. Indeed we expect that many personal pension providers will seek to match the stakeholder pension scheme standards.

Minimum standards

31 The minimum standards for stakeholder pension schemes will build on the 'CAT' standards (cost, access and terms), which are to be used for Individual Savings Accounts (ISAs). But compliance with the ISA CAT standards is voluntary. For stakeholder pension schemes, compliance with the standards will be a requirement for the scheme to be designated as a stakeholder pension scheme. We see no advantage – and potential confusion – in allowing stakeholder pension schemes which do not meet the standards to be established.

32 We propose to set minimum standards in a number of areas. We will require:

- **a simple charging structure, which members can understand and which allows ready comparisons between schemes. To avoid penalising those with small savings and those who stop paying into their scheme, we think charges should be levied in the form of a percentage, rather than a flat-rate sum. Charges could be levied as a percentage of the members' accumulated funds, or as a percentage of the contributions paid in. These will have different implications for scheme members and for scheme providers. We will consult on which of these two structures would be most appropriate;**
- **a limit on the permitted level of charges. There are risks in setting a maximum, which can become a minimum and discourage competition to get below it. But we think the reassurance of a fixed standard is needed to enable stakeholder pension schemes to meet their aims. The governance arrangements of schemes will ensure there is pressure to improve on the standard. The permitted charge level will be set later, following consultation. The limit on charges will cover all normal operating costs of the scheme. Schemes will be able to make extra charges only in respect of any additional services which they offer to members on a discretionary basis (for example, individual financial advice). There will be no additional entry or exit charges;**

- **that schemes which require minimum contributions should not set these to be more than a specified amount. Schemes would undertake to accept either one-off or regular contributions above this level;**
- **that schemes allow members to stop and re-start contributions without penalty;**
- **that members are able to transfer their funds to another scheme, at any time, and without any additional charge on their funds;**
- **that schemes should accept transfers of members' pension rights from other schemes; and**
- **that schemes provide members with at least annual information about the value of their pension, the contributions which have been paid in and the charges deducted by the scheme.**

33 Legislation for stakeholder pension schemes will at this stage provide the powers to specify the details of the minimum standards. We propose to consult on the minimum standards before setting out the final details. **We would welcome views on whether standards should be set in any other areas and on the specification of the standards discussed here.**

Governance

34 We need stakeholder pension schemes to be clearly run in the interests of their members and to be capable of acting on their behalf. Schemes will therefore need to adopt a structure which ensures this can happen.

35 The structure must be able to:

- **use the power of the members' contributions to ensure they get the best value-for-money;**
- **ensure the scheme complies with the minimum standards and other regulatory requirements; and**
- **provide the members of the scheme with high standards of service and with good-quality information about the scheme and about the members' pension rights within it.**

36 The well established means of meeting these aims in pension schemes is by using trust law, with a board of trustees responsible for overseeing the conduct and operation of the schemes. The great majority of private occupational pension schemes in the UK adopt this structure. Trustees in those schemes appoint the commercial companies who invest the scheme's funds on their behalf and provide administration services to the scheme. They also monitor regularly the performance of these organisations and may switch providers from time to time. The trustees in occupational schemes normally include the employer, but may also include representatives of scheme members. They normally appoint professional advisers to assist them.

37 We consider that trust law provides an appropriate framework for stakeholder pension schemes and that the presence of trustees in the schemes will ensure they are capable of meeting the aims we have set out for them. The legislation for stakeholder pension schemes will provide for schemes to be set up under trust law. The trust deed will need to give the trustees effective control of the scheme, so they can ensure it is run in the primary interest of its members. Many of the protections and benefits currently enjoyed by members of occupational schemes will therefore be available – for the first time – to those who work for employers who do not offer an occupational scheme and to the self-employed.

38 It is possible, however, that other arrangements could be capable of producing a comparable outcome for scheme members. And we would not want to rule out the development of new governance structures in the future. In order to provide sufficient flexibility, therefore, we will take the power to define, in secondary legislation, alternative governance arrangements which would be approved by the Secretary of State for Social Security as meeting the requirements to be stakeholder pension schemes. **We would welcome views from the pensions industry on alternative structures which could provide comparable benefits for stakeholder pension scheme members.**

39 The Treasury will also publish shortly a consultation document outlining proposals concerning investment by pension schemes. The proposals are designed to allow stakeholder pension schemes run under such alternative governance arrangements to invest funds in units in pooled investment schemes, in a transparent way. Such alternative investments could also be used by personal pension schemes. (Schemes run by trusts can already invest in that way.) This will increase the flexibility of such schemes, in that it would be straightforward for scheme members to adjust their investment exposures or indeed to move from one scheme to another as their circumstances change.

Regulation

40 We judge that the governance of trust-based stakeholder pension schemes would fall most naturally under the regulation of the Occupational Pensions Regulatory Authority (Opra). Opra already has considerable experience in regulating the conduct of occupational pension schemes and could regulate the conduct of trustees in stakeholder pension schemes in broadly the same way, dealing with reported problems as they arise.

41 As with personal pensions, the Financial Services Authority (FSA) will regulate the marketing of stakeholder pension schemes and advice on whether to join them, using powers under the Financial Services Act or its successor. The FSA will also authorise and supervise the firms responsible for managing the funds invested in stakeholder schemes.

42 The legislation for stakeholder pension schemes will therefore give Opra a role to regulate the governance of trust-based stakeholder pension schemes. As part of this, we propose also to apply to stakeholder pension schemes the main relevant provisions of the 1995 Pensions Act. Amongst other things, these will require the trustees of stakeholder pension schemes to:

- **produce an annual report and accounts;**
- **appoint professional advisers;**
- **draw up a statement of investment principles; and**
- **put in place procedures for dealing with internal disputes.**

43 Opra will also regulate the timely payment of contributions by employers, where we are proposing to introduce a common requirement across all pension schemes.

44 Members of stakeholder pension schemes, like members of occupational schemes, will have access to the Pensions Ombudsman as the mechanism for individual redress in the event of maladministration by the trustees and to the Financial Services Ombudsman for complaints about inappropriate advice or promotional material.

45 The proposed division of responsibilities reflects the current roles and expertise of both existing regulators. It does mean, however, that stakeholder pension schemes would have to deal with two regulators. **We do not expect this to lead to any significant problems, but we would welcome views on this choice**. We will consult on the regulatory arrangements for any alternative scheme structures which may be approved in the future.

46 The Inland Revenue would, as now, oversee the registration of stakeholder pension schemes to verify that schemes which register for favourable tax treatment do, in practice, satisfy the conditions. The Inland Revenue register would be shared with Opra.

47 For many people, joining a stakeholder pension scheme will involve similar decisions to those involved in joining a personal pension. The FSA will therefore have an important role in overseeing the quality of advice given, by setting the training and competency standards for those involved and ensuring compliance with their rules. This will be essential to avoid future mis-selling problems.

48 We intend to reduce, as far as possible, the need for individuals to seek financial advice when they consider joining a stakeholder pension scheme. We will work with the FSA to develop an information and advice regime for stakeholder pension schemes which meets these requirements. The fact that stakeholder pension schemes have to meet a number of minimum standards on charges and flexibility will play an important part in simplifying the decisions people have to make, particularly when leaving SERPS.

49 We propose to develop a 'decision tree' approach. The decision tree will allow potential members to work through a number of key questions about their own circumstances and it will clearly set out their options and encourage them to take advice when necessary. This would be a key part of the information provided by a scheme to any potential member. It should allow people to make an informed decision without advice in many cases. There will be a duty on the trustees of schemes to ensure that the required information is made available to potential members. The application of the FSA rules on financial promotion will ensure schemes are promoted in a way that does not mislead. Where employers agree to contribute to stakeholder pension schemes, the decision for the employee to join will be considerably easier.

50 Where people do need or want advice, we see scope for schemes to make arrangements to offer general advice to members and potential members, perhaps through telephone 'hotlines' or by having advisers visit the workplace. Collective schemes are also likely to be able to offer relatively low-cost individual advice from qualified financial advisers.

51 The process by which personal pensions are sold will also need to reflect the presence of stakeholder pension schemes. The FSA will consider how anyone giving advice on a personal pension should take into account the alternative offered by stakeholder pension schemes.

Workplace access

52 Much of the cost of providing most personal pensions arises from the process of contacting and recruiting potential customers, and then collecting contributions from them. To help stakeholder pension schemes achieve the aim of better value provision and to encourage people to join schemes, we propose to make significant changes to the way people come into contact with second pensions.

53 We want everyone in work to have access to a good value pension scheme through their workplace. This is already the case for those whose employers offer an occupational scheme. We propose to introduce a new requirement on other employers which will ensure that employees who cannot join an occupational scheme have access to a stakeholder pension scheme at their place of work. At this time, there will be no compulsion on employers to contribute to stakeholder pension schemes, but it will of course be open to them to do so.

54 The requirement will have two elements.

- **Employers who do not offer an occupational scheme will be required to identify a stakeholder pension scheme and to facilitate access to it for their employees. This will mean providing information to employees and allowing the nominated scheme a reasonable degree of access to the workforce to promote the scheme.**

- **Employers will be required, at the request of their employees, to deduct pension contributions direct from their pay and to pass that money to the nominated scheme within a specified period. We recognise that to contain costs this would need to be subject to a limit on the extent to which employees could opt to change the level of their contribution.**

55 We propose that employers will be exempted from these requirements in respect of employees who are eligible for an occupational scheme and any employees whose earnings fall below the National Insurance Lower Earnings Limit. So, for example, employers who already offer an occupational scheme to all their employees will not be affected.

56 While our aim is to provide access for all those who could benefit from joining a stakeholder pension scheme, we are concerned about the potential burdens on employers with very few employees who are mostly low-paid and likely to be better off in the new State Second Pension. **We would welcome views, therefore, on whether access should be on a voluntary basis for some groups of employers. We would also like to hear views on how best to incorporate employers who currently offer group personal pension arrangements, or who make contributions to personal pensions, so as to ensure that employees are not disadvantaged by any change.**

57 We propose to require employers to consult their workforce (or their representatives) on the choice of nominated scheme. The identification by employers of their nominated stakeholder pension scheme will be an important part of the process. Where employers make no existing provision, the choice of a stakeholder scheme should be uncomplicated. They may wish to engage independent advisers in selecting a stakeholder pension scheme that is suitable for their employees. Where employers already contribute to personal pension arrangements, they will need to consider whether they will offer the same contributions to employees who join a stakeholder pension scheme.

58 The requirements will come into force as soon as possible after the introduction of stakeholder pension schemes. We will, however, want to allow employers a reasonable period of time to make the necessary arrangements.

59 We are committed to minimising the impact on business from this new requirement. We believe the requirement set out here strikes a reasonable balance between the small additional burden on employers and the need to ensure wider access to good value pension schemes. Many employers will welcome the chance to give their employees access to a good value pension scheme.

60 There is also much that the schemes and their service providers can do to minimise the burden on employers. We would hope to see stakeholder pension schemes following the example of schemes in the USA, which offer software packages to employers to facilitate payroll deductions.

A clearing house

61 The initial requirement in respect of payroll deductions will require employers to pass contributions only to the single nominated scheme. Employees choosing to join other schemes would need to make their own arrangements, although it would be open to employers to provide this facility if they wished.

62 In time, however, we would look to extend the payroll deduction requirement so that contributions would be passed to any stakeholder pension scheme. But we wish to avoid imposing undue administrative responsibilities on employers. Before extending the scope of the requirement we believe it might well be desirable to have in place a suitable 'clearing house' arrangement which would allow employers to make a single payment in respect of all stakeholder pension schemes. The clearing house would then pass the money on to each scheme.

63 The Government will consult further on a clearing house and will look to develop ideas with the pensions and financial services industry and with employer groups, considering the main options for its development, its governance and how its costs would be recovered from those using it.

Development of stakeholder pension schemes

64 Stakeholder pension schemes will develop in a number of ways. All are likely to involve a partnership with financial service companies, but we expect schemes to fall into three main categories.

- **Those based on representative and membership organisations.**
- **Those set up by financial service companies.**
- **Those set up by employers.**

65 We have already seen a number of schemes set up under the personal pension framework, with the involvement of employers, to cater for people working for a number of different employers in the same industry. Others have been developed by trade unions. These schemes reflect the aims of stakeholder pension schemes, but we need to provide a statutory framework for such schemes which provides proper regulatory protection of their members and enables their costs to be reduced.

66 Schemes which develop around existing groups offer a number of advantages. The membership or affinity connection provides a means of recruiting scheme members without the need for expensive advertising or sales-forces. The link with a known organisation can also increase people's confidence in a pension scheme. And the organisation itself provides a source for scheme trustees who can be expected to represent the interests of scheme members. Trade associations and representative organisations could also provide a basis for schemes catering for the self-employed.

67 We also want to consult further on the scope for schemes to be set up by other organisations. Local government interests have suggested, for example, that appropriate councils with pensions expertise could be empowered to provide stakeholder pension schemes. These could be available for people not catered for by other schemes, or for those who may have a local or regional affinity. However, any prospect for local government being involved commercially in the provision of stakeholder pension schemes would need detailed analysis and assessment, taking full account of the financial and legal context within which local authorities must operate, and the statutory safeguards that would be required in connection with such an option.

68 Financial service companies may opt to establish their own schemes, subject to putting in place the necessary governance structure. Existing brand names could be a strong selling-point. Such schemes could also be directed at those self-employed people who are not catered for by schemes set up by representative organisations.

69 Single employers, or groups of employers, may set up stakeholder pension schemes for members of their workforces. These could be employers who do not offer occupational pension schemes at present. We expect many employers who currently offer group personal pensions, for example, will elect to offer stakeholder pension schemes in future.

70 We also see scope for employers to incorporate a stakeholder pension scheme into their occupational pension arrangements. There is already a trend within occupational provision for schemes to offer more of a mix of salary-related and money purchase arrangements. These reflect employers' aims to offer provision which better meets the needs of their workforce – traditional salary-related schemes can be relatively poor value for those who stay with the employer for a short time.

71 We envisage, for example, that employers might see advantages in having a stakeholder pension scheme for employees who do not qualify for membership of the main occupational pension scheme. The stakeholder element might then cover casual employees or others who have been with the employer only a short time. As these people became eligible they could switch to membership of the main occupational pension scheme. Or, if they moved on to a new employer, they could take their stakeholder pension fund with them.

72 The legislation for stakeholder pension schemes will therefore allow occupational schemes which comply with the requirements of a stakeholder pension scheme to be designated as such.

73 The advent of stakeholder pension schemes will be both a significant challenge and a business opportunity for the financial services sector. It is clear from other countries, such as the USA and Australia, and from the experience of occupational schemes in the UK, that the private sector can deliver highly efficient funded pensions. The Government will deliver the right statutory and regulatory framework. In turn, we look to the private sector to set up and run the new schemes.

Benefits

74 We expect stakeholder pension schemes will provide money purchase benefits, in which the pension is linked to the contributions paid in by individual members. This will mean accumulating a fund of savings which is normally used to purchase an annuity at retirement. Schemes may choose to offer within this a targeting arrangement, which allows members or their employers to aim for a particular pension level in relation, for example, to their earnings. It is also consistent with schemes which choose an insurance arrangement, to offer some elements of guaranteed benefits, or for pensions to be paid by the scheme itself, subject to meeting any charging limit. We do not propose to legislate to enable stakeholder schemes to offer salary-related benefits. Such arrangements require a person or organisation to provide a funding commitment and are more appropriate, therefore, for occupational schemes.

75 Stakeholder pension schemes will also be a means of contracting out of SERPS. This will not require schemes as a whole to take on contracted-out status, as in occupational schemes, but they will allow individual members to elect to contract out and to have a rebate paid to their scheme. We have said that we plan to review the structure of contracting-out rebates in the light of stakeholder pension schemes. One of our aims in that review will be to make the contracting-out decision in respect of stakeholder pension schemes as straightforward as possible and not one which normally requires individual financial advice. Under the proposals set out in **Chapter Six**, the contracting-out rebates would be increased, on the introduction of the new State Second Pension, to reflect the higher levels of benefit foregone by those earning under £18,500 a year.

76 It is not our intention to prescribe all the details of stakeholder pension schemes. Many key decisions will be for the sponsors of the scheme, the providers and the trustees to take when the schemes are set up. This will allow them to reflect the needs of the particular scheme.

77 These will include:

- **the benefits to be provided by the scheme;**
- **the scheme's normal retirement age;**
- **its investment strategy;**
- **the investment choice offered to members; and**
- **any restrictions on membership.**

78 Some schemes may elect, for example, to offer members a degree of investment choice. Others may elect to adopt a fully collective approach to investment, with all members' funds held in the same portfolio overseen by trustees. We would, however, expect stakeholder pension schemes to offer their members an appropriately simple and understandable arrangement and also to take steps to protect the value of members' funds as they approach retirement.

79 There will be some limitations on the benefits which can be provided, in line with existing tax and contracting-out rules. We propose that the benefit restrictions for stakeholder pension schemes should follow those for personal pensions, that is, pension age will be between 50 and 75, a tax-free lump sum will be available, and income drawdown will be allowed. For those who contract out of SERPS and receive National Insurance rebates, any protected rights held by the scheme will not be available until the age of 60 and may not be taken as a lump sum. The existing contracting-out requirement to provide a survivor's benefit for a legal spouse will also apply.

80 We also want to consult further on the extent to which stakeholder pension schemes could provide access to other additional benefits. As collective schemes with bargaining power, we would expect stakeholder pension schemes to be able to offer good value access to other arrangements, such as life insurance cover to provide for survivors and 'waiver of premiums' cover which allows contributions to the pension to continue if the member becomes ill or disabled.

The tax regime

81 As with other pension schemes, contributions to stakeholder pension schemes will qualify for tax relief. Investment income and capital growth within the schemes will also be exempt from tax. The resulting pension will be taxable, except that part of the fund (excluding protected rights deriving from National Insurance rebates) may be taken as a tax-free lump sum.

82 Additionally, however, we propose some simplification of the tax regime for stakeholder pension schemes.

- **Contributions to the scheme will be limited to a fixed sum of £3,600 a year, or 100 per cent of the member's earnings, whichever is lower. Therefore, it will not be necessary for schemes to check contributions against earnings for the great majority of scheme members. This will help to reduce administration costs and will also be clearer for scheme members with low earnings than contribution limits expressed as a percentage of earnings. The contribution limit will apply to the sum of any individual and employer contributions, but will not include the value of any National Insurance rebates.**
- **Scheme members who stop working will be able to continue to contribute, with tax relief, up to the annual limit, for a period of up to five years. This is a simpler alternative to the arrangements in personal pensions which allow contribution relief to be carried forward and contributions to be carried back to earlier years. It will provide – in a simple form – considerable flexibility for carers and those who take career breaks to have children, to keep building up their pension, where they can afford to do so.**

83 Both these changes will help to reinforce the complementary relationship between stakeholder pension schemes and ISAs. By allowing people to transfer money from ISAs into stakeholder pension schemes both when they are in and out of work, with tax relief, they will provide flexibility between different forms of saving. People who are reluctant to commit their savings initially to a pension will be able to use tax-privileged ISAs as a holding fund for their savings and to transfer them into a pension, within the set contribution limits, when they feel it is right to do so.

84 The changes will also make it easier for partners to contribute to each other's pensions, again within the overall contribution limits, should they choose to do so.

85 More detailed aspects of the tax regime for stakeholder pension schemes will be decided in due course.

Timetable

86 The primary legislation needed to put in place the basic framework for stakeholder pension schemes will be included in the Bill for welfare reform to be presented to Parliament in the current session. As is normal, many of the detailed aspects will be set out later in secondary legislation once the Bill has received Royal Assent. We intend to consult fully on the detail of the proposals, through responses to this Green Paper, the further specific consultation exercises referred to in this chapter, and by consulting on the detail of the secondary legislation.

87 We are determined to make progress as quickly as possible in introducing stakeholder pension schemes. That is why we are introducing the framework legislation now. The precise timing of the further stages will depend on a number of factors, but our aim is to enable the first stakeholder pension schemes to be set up from April 2001.