RESEARCH PAPER 01/69
31 AUGUST 2001

Stakeholder Pensions

Stakeholder pensions were introduced from 6 April 2001. They are a new form of private pension and form an integral part of the government's overall pension policy, the central objective of which is to change the ratio of state to private provision from the current 60:40 to 40:60 by 2050. Other elements of this developing policy area include the new State Second Pension to be introduced from April 2002 and the proposed Pension Credit.

From 8 October 2001, employers with five or more employees must comply with the access arrangements for stakeholder pensions. These include, where necessary, identifying a registered scheme and making details of it available to all relevant employees. The government believes these arrangements will increase the availability and take up of stakeholder pensions.

This paper describes the new stakeholder pensions, examines their role in the range of private and public pension provision, and summarises the emerging results on take up. It also discusses the government's pension policy in the light of previous attempts to establish a long-term and sustainable pension framework.

Tim Jarvis

BUSINESS AND TRANSPORT SECTION

HOUSE OF COMMONS LIBRARY

Recent Library Research Papers include:

01/54	General Election Results, 7 June 2001	12.06.01
01/55	Unemployment by Constituency, May 2001	13.06.01
01/56	Animal Experiments	20.06.01
01/57	The Irish Referendum on the Treaty of Nice	21.06.01
01/58	The *Homelessness Bill* [Bill 2 of 2001-02]	26.06.01
01/59	The Monetary Policy Committee: theory & performance	26.06.01
01/60	Economic Indicators	02.07.01
01/61	The *European Communities (Amendment) Bill*: Implementing the Treaty of Nice [Bill 3 of 2001-02]	28.06.01
01/62	The *European Communities (Finance) Bill* [Bill 1 of 2001-02]	02.07.01
01/63	The *Electoral Fraud (Northern Ireland) Bill* [Bill 6 of 2001-02]	05.07.01
01/64	The *Export Control Bill* [Bill 5 of 2001-02]	05.07.01
01/65	Unemployment by Constituency, June 2001	18.07.01
01/66	The National Lottery	19.07.01
01/67	Farming after Foot and Mouth	20.07.01
01/68	Unemployment by Constituency, July 2001	15.08.01

Research Papers are available as PDF files:

- *to members of the general public on the Parliamentary web site,*
  URL: ***http://www.parliament.uk***
- *within Parliament to users of the Parliamentary Intranet,*
  URL: ***http://hcl1.hclibrary.parliament.uk***

Library Research Papers are compiled for the benefit of Members of Parliament and their personal staff. Authors are available to discuss the contents of these papers with Members and their staff but cannot advise members of the general public. Any comments on Research Papers should be sent to the Research Publications Officer, Room 407, 1 Derby Gate, London, SW1A 2DG or e-mailed to PAPERS@parliament.uk

ISSN 1368-8456

Summary of main points

Stakeholder pensions are a new form of private pension which began to be sold from 6 April 2001. Much of the existing legislation covering occupational and personal pensions applies to stakeholder pensions. They also operate within a new regulatory framework which sets minimum standards and the detailed rules about how they operate. Firms wishing to offer stakeholder pensions have been able to apply to register them as such with the Occupational Pensions Regulatory Authority (OPRA) since 2 October 2000. The Financial Services Authority regulates the sale and promotion of stakeholder pensions.

From 8 October 2001, employers with five or more employees must comply with new access arrangements for stakeholder pensions. The requirements include identifying a scheme and supplying details of it to all relevant employees; allowing employees reasonable access to representatives of the scheme; and deducting contributions from wages and paying them to the designated schemes if the employee requests. Employers will not be required to contribute to an employee's stakeholder pension. Penalties for non-compliance include fines of up to £5,000 for an individual acting as an employer and up to £50,000 for a company.

The design of stakeholder pensions and the associated tax regime has been the subject of a detailed consultation process. Issues such as the maximum charge for stakeholder pensions and the question of whether individuals would be able to pay into a stakeholder pension and an occupational pension concurrently, proved particularly controversial during the consultation process. Much debate has centred on the question of whether the new pensions would reach the government's stated target group: those with earnings between £10,000 and £20,000 per year who do not have access to a good occupational pension scheme and for whom personal pensions may be poor value. The government's decision to allow partial concurrency opens up the market for stakeholder pensions to people outside the original target group but the success of the policy is likely to be measured by the degree of take up from the original target group.

Stakeholder pensions form part of a wider pension policy and there have been a number of developments in this area since the Labour government took office in May 1997. These include the Minimum Income Guarantee introduced in April 1999; the State Second Pension, rights to which will build up from April 2002; and the Pension Credit, on which the government proposes to legislate in this session. In recent months concern has been expressed, most notably by the Institute for Public Policy Research (IPPR), about how these different parts of the pension system fit together. Such an analysis may be seen in the context of previous attempts in the post-war period to develop a sustainable and effective pension policy which is supported by a broad political consensus.

Early figures published by the Association of British Insurers (ABI) in August 2001 show that nearly 90,000 employers had designated a stakeholder pension scheme for their employees. They also show that 224,506 stakeholder pensions were sold in the first three months since they were launched in April 2001. This includes some conversions from pre-existing pension arrangements.

CONTENTS

I	**Background**		7
II	**The Legislative Framework**		8
	A.	The *Welfare Reform and Pensions Act 1999*	8
	B.	The *Stakeholder Pensions Regulations 2000* and a new tax regime	9
	C.	Regulatory Impact Assessment	12
III	**Reaction and issues**		13
	A.	Employer access arrangements	14
	B.	Maximum charges	15
	C.	Advice and contracting out	15
	D.	Concurrency and the new tax regime: the "target" and "market" groups	18
	E.	Compulsion?	20
IV	**Early take-up figures and survey evidence**		22
V	**The search for a consensus on pension policy**		25
	A.	Introduction	25
	B.	Development of the current pension framework since 1946	27
	C.	Current government policy: a new pension settlement?	29
VI	**Further reading**		32
	A.	General information	32
	B.	Government consultation documents	32
	C.	Other reading	33

I Background

In its manifesto for the 1997 General Election, the Labour Party said that if elected it would create a new framework of stakeholder pensions which would provide "high standards of value for money, flexibility and security".[1] In December 1998, the DSS published its pensions Green Paper, *Partnership in pensions*, following a review of pension provision which the government had initiated shortly after the 1997 election.[2] The Green Paper contained details of the proposals for new stakeholder pensions and set out the philosophy which underlies them:

> 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.**[3]

The target group for the new pensions are those in the workforce on moderate earnings who do not have access to good occupational schemes and for whom personal pensions are poor value, largely because of their high charges. The government states that there are approximately five million people who are not in an occupational scheme and who have earnings between £10,000 and £20,000 per year.[4] Although this constitutes the main target group for stakeholder pensions, the new tax regime which breaks the link between earnings and pension contributions, and the government's decision to accept partial concurrency, mean that many people outside this target group are also able to join a stakeholder scheme.

---

1 Labour Party, *New Labour because Britain deserves better*, April 1997, p 18
2 DSS, *A new contract for welfare: partnership in pensions*, Cm 4179, December 1998
3 pp 50-51
4 HC Deb 10 April 2000 c 25W

II The Legislative Framework

Section 1 of the *Pension Schemes Act 1993* defines two types of pension scheme: an occupational pension and a personal pension. Different legislative requirements and tax rules apply to each type of scheme. These two types of scheme can also now be registered as stakeholder pensions provided they meet certain additional criteria set out in the legislation. These were established by the *Welfare Reform and Pensions Act 1999* and regulations made under it. The *Finance Act 2000* introduced a new tax regime for defined-contribution pension schemes, including stakeholder pensions, from 6 April 2001.

A. The *Welfare Reform and Pensions Act 1999*

Provisions in Part I of the *Welfare Reform and Pensions Bill 1998/99* set out the proposed legislative framework for stakeholder pensions and the Bill received its Second Reading in the House of Commons on 23 February 1999.[5] The Bill, which included a number of other unrelated social security measures, received Royal Assent on 11 November 1999. The main provisions in the Act relating to stakeholder pensions are:

- A stakeholder pension can be either a personal or an occupational pension provided that it is registered as such and complies with the legislative requirements. These requirements include factors such as the governance of the scheme, and charges and expenses which are set by regulation.

- Stakeholder pensions are money purchase schemes, also known as defined-contribution schemes. (The Act does provide for regulations to prescribe exceptions to this rule but these powers have not been used to date).

- The Occupational Pensions Regulatory Authority (OPRA) has a duty to keep a register of stakeholder pension schemes and has the power to de-register a scheme if it does not comply with the regulatory requirements.

- From 8 October 2001, employers must provide access to stakeholder schemes and comply with other requirements under section 3 of the Act. Therefore, employers have six months from the introduction of stakeholder pensions to comply with their obligations under the legislation. The requirements involve:

    - identifying a scheme that is open to all employees;
    - supplying details of it to employees;
    - allowing employees reasonable access to representatives of the scheme; and

[5] Bill 44 of 1998/99

- deducting contributions from wages and paying them to the designated schemes if the employee requests.

Exceptions to these requirements are contained in the regulations. Penalties for non-compliance are provided for by section 10 of the *Pensions Act 1995*. These civil penalties include fines of up to £5,000 for an individual who is an employer and up to £50,000 for a company. OPRA is responsible for ensuring compliance with the employer access provisions and enforcing penalties.

- Members of stakeholder schemes are able to opt out of SERPS and to have a National Insurance rebate paid to their scheme. They will also be able to opt out of the new State Second Pension when it is introduced. The State Second Pension will replace SERPS, from April 2002, under provisions contained in the *Child Support, Pensions and Social Security Act 2000*.[6]

The original Green Paper set out seven areas where the government would be seeking further views: minimum standards; employer access; the potential for a clearing house facility; advice and information; the regulatory regime; trusts and alternative governance structures; and the tax regime and rebates. During the passage of the Bill, in the summer and autumn of 1999, the government published a series of consultation papers on these issues. The results of this consultation were announced at the beginning of 2000 and draft regulations were issued for further consultation in February and March 2000 before the final version of the regulations was laid. These were further amended before April 2001. Section VI contains further reading and includes a list of consultation documents published by the government and the FSA on stakeholder pensions.

B. The *Stakeholder Pensions Regulations 2000* and a new tax regime

The detailed rules of stakeholder pensions are contained in the *Stakeholder Pension Regulations 2000*.[7] These confirm the main features of stakeholder pensions.

Minimum standards

The maximum charge for a stakeholder pension is 1/365% of the fund value for each day it is held; effectively an annual charge of 1% (regulation 14(3)). This should cover all aspects of the management of the scheme and its funds, and charges may not be made for joining or leaving a scheme. Schemes may offer other services, such as advice, for which they can make an additional charge under a separate contract but such a contract may not be made a condition of scheme membership (regulation 16). As a pension scheme within the definition contained in section 1 of the *Pension Schemes Act 1993*, rights to a

---

[6] see House of Commons Library Research Paper 99/109

[7] SI 2000/1403, as amended by the *Stakeholder Pension Scheme (Amendment) Regulations* SI 2001/104 and the *Stakeholder Pension Scheme (Amendment)(No. 2) Regulations* SI 2001/934

stakeholder pension may be transferred into another scheme, subject to certain limitations. Transfers in to a stakeholder scheme from an approved pension scheme must be accepted without charge. There is currently no similar obligation on occupational and personal pensions though many schemes provide for such transfers.

Schemes must accept regular, or one-off, contributions above a minimum level of £20 (regulation 17). The scheme instruments may permit the trustees or scheme manager to refuse to accept any payment to the scheme of less than this amount. Schemes are required to accept contributions in the form of cheques, standing orders, direct debit and direct credit but may refuse contributions in other forms, such as by cash, credit card or debit card (regulation 3(5B)).

Governance

Schemes may be trust based. Alternatively they can be set up on the basis of a contract with an FSA authorised scheme manager including authorised corporate directors of open ended investment companies (OEICs) (regulation 2). The regulations specify the detailed requirements to be included in the rules of trust-based schemes and contract-based schemes. All types of stakeholder schemes may now be restricted to those in a certain trade or profession, or member of a particular organisation (regulation 3(10)). Following lobbying from the industry, the provisions were amended to allow FSA authorised contract-based schemes to restrict membership in the same way as trust-based schemes.[8] One-third of trustees must be independent of the scheme manager or provider (regulation 4(3)) but, the provisions relating to member nominated trustees in occupational pension schemes do not apply to stakeholder schemes (regulation 30).

Investments

There must be a default investment option for those joining a stakeholder pension scheme; investors may be given the option of choosing in what way their pensions are invested but they cannot be required to make a choice (regulation 3(3)). The managers of a contract-based stakeholder scheme must produce a written statement of the principles governing investment decisions including the policy on the types of investments to be made, risk and the expected return (regulation 9(4)). With-profits policies may be offered provided they are done so within the 1% charge and the scheme does not invest in any with-profits funds that include non-stakeholder assets. Trustees or managers must obtain a written contract from the insurance company stating that, while the scheme has assets invested in the with-profits fund, the insurer will ensure that all stakeholder pension scheme members are treated equally and that the charging rules can be complied with. (regulation 15).

---

[8] SI 2001/104, regulation 3

Detailed information on contributions, fund growth and charges must be provided to members at least once a year in an annual benefits statement (regulation 18). This regulation was amended to allow schemes to issue annual benefit statements over the year rather than issuing them all at once.[9]

Employer access

Regulations 22 and 23 set out the exemptions from the general requirement, in section 3 of the *Welfare Reform and Pension Act 1999,* that employers must provide access to a registered stakeholder scheme from 8 October 2001. Employers with fewer than five employees will be completely exempt from the requirements (regulation 22(1)). Employers who arrange a group personal pension plan <u>and</u> offer contributions of at least 3% of basic pay will be exempt in respect of those employees who are offered membership of the group plan (regulation 22(2)-(4)). Similarly, employers who offer an occupational scheme will be exempt from the requirements in respect of those employees who may join the scheme within 12 months of starting work (regulation 23(1)(a)).

Employers who are not completely exempt from the requirements, or who have employees who do not have access to an occupational scheme or group personal pension plan, must provide access to a designated stakeholder scheme. They must provide payroll deductions but may limit changes to the level and frequency of employee contributions to once every six months (regulation 24(2)). Employers are <u>not</u> required to contribute to a stakeholder scheme.

Tax regime

Stakeholder pension schemes are part of a new defined-contribution tax regime which came into effect on 5 April 2001. The provisions are contained in section 61 and schedule 13 to the *Finance Act 2000*. Under the regime, people may invest up to £3,600 per year in a defined-contribution stakeholder, personal or occupational pension scheme regardless of any earnings. The removal of any link with earnings means that someone without earnings can contribute to a private pension and benefit from the tax relief on contributions and investment growth. This has effectively opened up the market for stakeholder pensions by, for example, enabling high earners to make contributions on behalf of a non-earning spouse or other family member. For the approximately 5% of people who contribute more than £3,600 per year, contributions are restricted to the pre-existing age and earnings-related limits for personal pensions.

The government ruled out allowing all people with defined-benefit (final salary) pension schemes to hold a stakeholder pension concurrently. It did, however, agree to look at options for partial concurrency which would enable moderate earners with a defined-benefit occupational scheme to invest in a stakeholder pension as well. On 5 July 2000

---

[9] SI 2001/934, regulation 13

the government announced that those in an occupational pension scheme, who earn under £30,000 a year, will also be able to contribute to a defined-contribution scheme up to the £3,600 a year limit.[10] This concurrency covers eight million savers in occupational pension schemes, nearly 90% of the total.[11] The arrangements for partial concurrency were incorporated into schedule 13 of the *Finance Act 2000* which inserted a new section 632B in to the *Income Corporations and Taxes Act 1988*.

The *Finance Act 2000* made other changes to the tax rules relating to pensions from 6 April 2001:

- 10% of the pension contribution can be used for life assurance. The previous limit was 5% of relevant earnings.
- The practice of granting tax relief for insuring against the inability to pay contributions by taking the premium out of the pension contributions ended on 5 April 2001. Instead tax relief is now provided on contributions made from such a policy when it pays out. Policies may also be opened up to cover other eventualities such as unemployment.
- Shares from an approved employee share scheme can, within the contribution limits, be transferred into the pension and attract tax relief. The transfer must take place at market value. This mirrors the arrangements for transfers into an Individual Savings Account (ISA).

C. Regulatory Impact Assessment

The government published a Regulatory Impact Assessment (RIA) on stakeholder pension schemes in June 2000.[12] The estimated non-recurring costs to business of stakeholder pensions have been reduced by £40m to £100m from the original estimate based on the *Welfare Reform and Pensions Act 1999*. This reduction is largely the result of the exemptions for certain categories of employers from the stakeholder requirements. A table in the RIA summarises the costs and benefits of the proposals and this is reproduced below:

[10] Inland Revenue press release, *Concurrency announced for stakeholder pensions*, 5 July 2000
[11] Ibid
[12] Inland Revenue, *Regulatory Impact Assessment: stakeholder pension schemes*, June 2000

	Expected costs	Expected benefits
Employers	(i) Recurring costs to employers of around £15 million for each 1 million employees who join stakeholder pension schemes; and £1 million additional levy costs. (ii) Non-recurring costs of £100 million.	
Charities	Nil (except in their capacity as employers)	
Citizens	(i) up to 5 million people are in the target group for stakeholder pension schemes. The costs of contributing are voluntary and therefore avoidable.	(i) Availability of good value second pensions to up to 5 million people who currently do not have access to suitable schemes. (ii) Improved portability of pensions through stakeholder pension schemes. (iii) Improved security for pension scheme members; better information for members of schemes; and improved second-tier pension provision .
Government	Expected outcome of stakeholder pension schemes and other moves to make funded pensions more attractive is for more to contract-out leading to a loss of National Insurance revenue of £0.7 bn for every million who do so.	Some offsetting savings from non-eligibility for state second pension.

III Reaction and issues

The final design of stakeholder pensions was the result of a long consultation process between the publication of the Green Paper in December 1998 and the laying of the main regulations on 25 May 2000 and the publication of the provisions in the *Finance Act 2000*. The main regulations were also subsequently amended following further lobbying from the pensions industry.

Issues such as the minimum standards for stakeholder pensions and the role of advice dominated much of the early debate. However, it was on the questions of employer access and concurrency that the government made significant concessions after lobbying from employers' groups and the pension industry. Although much of the response to the consultation on the detailed design came from interest groups, as the final design has become clearer, a number of commentators have examined the role of stakeholder pensions in the context of the government's wider pension policy. Central to this debate is the question of compulsory private pension saving. Although rejected by the government at the Green Paper stage, it is an issue which continues to dominate much of the debate and is likely to continue to do so if the government's target group does not take up stakeholder pensions in significant numbers.

A. Employer access arrangements

The government originally proposed to offer only very limited exemptions from the requirement for employers to designate and provide access to a stakeholder pension. The CBI and the Federation of Small Businesses both criticised these proposals and argued that they would place a large burden on small employers.[13] The Opposition put forward these arguments in parliament and introduced a number of amendments during the passage to the *Welfare Reform and Pensions Bill* which would have exempted firms with fewer than ten employees. The government's final decision to exempt employers with less than five employees can be seen as a response to these criticisms though others have argued that the effect will be to reduce take up of stakeholder pensions. The employer access requirements are intended to ease access for the target group and reduce the costs of distribution. During the debate on the main stakeholder regulations Steve Webb, Liberal Democrat spokesperson for social security, pointed to figures in the Regulatory Impact Assessment which suggest that 15% of the target market work for firms which will not be required to provide access to a stakeholder pension or make payroll deductions.[14] The government intends to review the small firm exemption in 2004.[15]

There are also concerns that the employer access requirements will encourage employers to move away from good quality occupational pension schemes. Some commentators, while welcoming the structure for charges and the relative flexibility of stakeholder pensions, have suggested that many firms will decide that it will be easier and cheaper to abandon final salary schemes and adopt stakeholders.[16] It remains to be seen whether the introduction of stakeholder pensions will, of itself, encourage significant numbers of employers to reduce the existing provision for employees. Occupational pensions are often a significant element of remuneration packages and form part of employers' recruitment and retention policies. Prior to the introduction of stakeholder pensions, there has already been some evidence of a movement away from expensive final salary schemes. While employers usually point to the cost and complexity of such schemes, some critics argue that the introduction of a new low cost money-purchase pension option may become a contributory factor in firms' decisions. However, it is possible that the employer access arrangements could have the opposite effect in some cases and lead to an extension of occupational pension provision. Some employers whose current provision does not exempt them from the stakeholder requirements, for example because the occupational pension is not available until employees have worked for the company for more than one year, may decide it is simpler to extend their existing provision rather than make completely new arrangements.

---

[13] CBI news release, *Direction of Government consultation on stakeholder pensions "encouraging" - CBI*, 29 June 1999 and "Small firms must offer stakeholder pensions", *Times*, 30 June 1999

[14] 8th SCDL 13 July 2000 c 12

[15] DSS, *Stakeholder pensions: outcome of the consultation*, 10 January 2000

[16] "Pensions at stake in brave new era", *Financial Times*, 11 June 2000

B. Maximum charges

The issue of maximum charges proved controversial during the consultation period on the detail of stakeholder pensions. The government resisted pressure from major insurance companies, such as Standard Life, to increase the maximum 1% charge. The pensions industry appears to have largely accepted the 1% overall limit and despite initial concerns that few companies would consider it profitable to meet the minimum standards and register a stakeholder product, there were 48 registered stakeholders at 20 August 2001.[17] Within these products there is a range of charges up to the 1% limit. Most providers have different charging structures for different circumstances. Group schemes sold to employers or affinity groups are more likely to be able to offer lower charges than those products sold to individuals.

The lowest charges do not necessarily mean the best deal for consumers: future investment returns will be the biggest factor in determining the size of the fund that builds up. Indeed, some commentators reject the idea that capped charges necessarily lead to better products. There is still likely to be a market for personal pensions which do not meet the stakeholder minimum standards because they will be able to offer a wider range of investment options. One commentator suggests that, after taking into account distribution and administration costs, stakeholder providers will only be able to spend about 0.33% on fund management and still make a profit.[18] He argues that this will not be enough to invest in the major pooled pension funds and suggests that personal pensions could therefore outperform stakeholder pensions. This may offset any gains from lower charges. The article concludes that "those who want to buy the cheapest products will choose a stakeholder pension, while investors who do not want to compromise on investment will favour personal pensions".

C. Advice and contracting out

A number of respondents expressed concern about the availability and cost of advice. Under the regulations this must be provided within the 1% limit or charged as part of a separate contract which cannot be made a condition of sale. Some argued that the question of concurrent membership of stakeholder pensions, and other occupational and personal pensions, is crucial to consideration of the question of advice. If individuals do not have to choose between a stakeholder, a personal pension or an occupational pension, or whether to leave one for another, then the need for advice is likely to be reduced and this appeared to influence the government's decision to allow partial concurrency. In a further attempt to reduce the need for expensive individual advice, the government proposed decision trees to help consumers understand stakeholder pensions and the FSA published proposals in a discussion paper on the regulation of the conduct of stakeholder

[17] http://stakeholder.opra.gov.uk/registrysearch.asp

[18] "Why compromise?", Peter Jordan, head of pensions marketing at Skandia Life in *Money Management Personal Pension supplement*, March 2001

business in May 2000.[19] The FSA originally intended to mandate their use in the selling process. However, the final rules issued by the Personal Investment Authority (PIA) and the Investment Management Regulatory Organisation (IMRO) state that decision trees do not have to form part of the "key features document" which must be given to customers at the start of the sale process.[20]

It is unlikely that partial concurrency and decision trees will preclude the need for individual advice for all potential purchasers. For example, the final version of the decision trees do not deal with the specific question of whether the respondent should contract out of SERPS. Employees who contract out of SERPS pay a lower rate of employee National Insurance Contributions (NICs), on their earnings between the lower and upper bands of National Insurance, than those who remain in SERPS. Similarly, employers also pay a lower rate of NICs in respect of contracted-out staff. The difference between the contracted-in and contracted-out rates of NICs is commonly known as the rebate and must be invested in an approved private pension.

A number of respondents to the original stakeholder pension proposals argued that personalised comparisons with benefits foregone were still essential for those considering contracting out and that a general decision tree would be insufficient. The PIA rules therefore state that firms wishing to promote contracting-out should do so outside of the prescribed decision trees and follow the existing requirements for personalised comparisons with the SERPS benefits being given up. The FSA guidance for consumers acknowledges that the decision about contracting out will be less clear for those who are older and have low earnings.[21] It suggests that those who need help with this decision should seek financial advice, for which a charge will be made, and review the decision regularly, particularly after the introduction of the State Second Pension in April 2002.

Arguably, the decision on whether to contract out or not is likely to be one of the most important for some in the target group. Some commentators have criticised the level of the contracted-out rebates which are paid in respect of those contracting out. It is argued that these are too low and make the decision to contract out more difficult that it need be.[22] Section 42 of the *Pension Schemes Act 1993* requires that at least every five years, the Government Actuary reviews the value of the rebate for those contracted out. The Actuary must consider any changes since the previous report which may affect the "cost of providing benefits of an actuarial value equivalent" to the SERPS foregone.[23] Thus the basic purpose of the rebate is to ensure that people who opt out of the state scheme still have a pension that is in some way equivalent to the SERPS that they would have

---

[19] FSA, *The FSA's approach to the regulation of the conduct of stakeholder pensions business*, May 2000

[20] The rules issued by IMRO and the PIA provide the appropriate regulatory framework until the FSA assumes its full powers under the *Financial Services and Markets Act 2000* which is expected to be in the second half of 2001.

[21] *FSA Factsheet: stakeholder pensions and decision trees*, March 2001, p 11

[22] IPPR, *A new contract for retirement: an interim report*, August 2001, p 11

[23] Section 41(1)(a)(ii) *Pension Schemes Act 1993*

received had they stayed in. There is, however, no guarantee that the rebates invested in a private pension will produce a final pension of an amount equivalent to the state benefits foregone.

The Government Actuary reported to the Secretary of State for Social Security in January 2001 and his recommendations for the next five years, and the Secretary of State's decisions, were published in March 2001.[24] The new rebates will take effect from April 2002. There are not separate contracting out terms for stakeholder pensions. Approved personal pensions (APPs) registered as stakeholder pensions will contract out on the basis of the APP rebates; employers' contracted out money purchase schemes (COMPS) which are registered as stakeholder pensions will contract out on the basis of the COMPS rebates. As they are money purchase schemes, rebates for stakeholder pensions are age-related. Age-related rebates were introduced from 6 April 1997 under the *Pensions Act 1995* because it was felt that, as things stood, it was likely to be to the advantage of older people to stay in SERPS or even, if they had contracted out when they were younger, to opt back in.[25] This is because the pension paid by a money purchase scheme depends to a large extent on how the invested rebates grow: the rebates of younger people are invested for a longer period and are therefore likely to produce a larger pension fund.

From April 2002, the rebates for personal pensions will range from, for example, 4.4% at age 20 to 9.9% at age 50. When the age-related rebates were introduced in 1995, the then government decided to place a cap on the rebate because it argued that the cost of the rebates that would have been necessary at higher ages would have been unacceptably high. Although the present government has increased the cap, from 9% to 10.5%, in order "to restrain the costs to public finances",[26] the effect of it means that it may be beneficial, in some circumstances, for some older people to contract back into SERPS. For example, the Government Actuary estimates that for an individual aged 55, who wishes to contract out with an approved personal pension, a rebate of 15.2% would be required in 2002/03. The actual rebate paid will be capped at 10.5%.

In an article about setting the level of the contracted-out rebates, the Government Actuary acknowledges that this process involves a degree of compromise:

> Setting the rebate terms inevitably involves some compromises. Giving more to the contracted-out means charging more to whose who are not contracted-out. Increasing the generosity of the terms, particularly for personal and stakeholder pensions, may make the corresponding private sector product more marketable but will also raise criticism that the government is paying over the odds to

[24] Reports by the Government Actuary and the Secretary of State for Social Security, *Occupational and personal pension schemes: review of certain contracting out terms*, Cm 5076, March 2001

[25] See, eg Lord Mackay's speech on Second Reading of the *Pensions Bill 1994/95* in the House of Lords (HL Deb 24 March 1995 c 978).

[26] Reports by the Government Actuary and the Secretary of State for Social Security, *Occupational and personal pension schemes: review of certain contracting out terms*, Cm 5076, March 2001, p 25

> transfer liabilities to the private sector. The adequacy (or otherwise) of the rebate is posed in particularly clear-cut terms with money purchase contracting out, where the provider of a personal or stakeholder pension has to demonstrate that what is on offer is good value compared to the alternative of remaining in SERPS.[27]

D. Concurrency and the new tax regime: the "target" and "market" groups

The question of concurrent membership of stakeholder pensions, and other money purchase schemes, and final salary occupational schemes had wider implications than simply reducing the need for advice and it proved one of the most controversial issues throughout the consultation on the detail of stakeholder pensions. Some commentators argued that the government's final decision could influence both the final level of take up and the potential for mis-selling, or more accurately "mis-buying", as a result of insufficient individual advice. The government was concerned that allowing full concurrent membership would lead to providers "cherry picking by selling to the better off rather than to people without existing pension provision".[28] It would also have costs to the Exchequer because of the tax advantages that would be extended to higher earners as a result of allowing concurrent membership. The National Association of Pension Funds (NAPF) criticised the government's original decision to rule out full concurrent membership. The director of the NAPF described this as "very short-sighted and very misguided" because most people are still in final salary schemes and making them choose could lead to problems of mis-selling.[29]

The government's decision to allow concurrent membership for those earning less than £30,000 per year was therefore broadly welcomed. Alan Pickering, then chair of the NAPF, described it as the "single most important announcement made by the government in the pension review".[30] The cost in extra tax relief of the concession is reported to be £155m a year by 2010.[31] However, the difficulty of balancing the competing requirements of simplifying the system while limiting the loss to the Exchequer has been highlighted by this concession. Some financial advisers argue that, as the legislation currently stands, those who earn over £30,000, and have access to an occupational pension scheme, can still take advantages of the tax concessions offered by stakeholder pensions if they also have what may amount to only a very small amount of freelance earnings.[32] This is because freelance earnings are treated separately and it opens up the possibility of higher earners acquiring fairly negligible freelance earnings in order to take

---

27 "Contracting out: a partnership between public and private pensions", *PMI news*, July 2001

28 DSS and Inland Revenue, *Stakeholder pensions: details of the tax regime and draft Finance Bill clauses*, 22 February 2000, p 5

29 "Ministers demolish pension barriers", *Guardian*, 17 September 1999

30 "Stakeholder pensions opened to 8m in occupational schemes", *Financial Times*, 5 July 2000

31 Ibid

32 "Retirement planning", Observer, 29 April 2001

advantage of tax relief of up to 40% on savings up to £3,600 per year. This has been described as a "loophole ready to be exploited - and rapidly sealed off by the tax authorities".[33]

The new tax regime and the decision to allow partial concurrency has opened up the market for stakeholder pensions from that originally envisaged. This has led to some concerns that much of the take up of stakeholder pensions will come from those outside the government's target group and, in particular, higher earners. For example, the new tax regime from April 2001 no longer requires an individual to be in receipt of earnings to take out a defined-contribution pension and receive the tax breaks associated with this form of savings. Therefore, higher earners can use stakeholder pensions to make tax efficient provision for a non-earning spouse or their children and grandchildren and many newspaper financial supplements have highlighted the advantages of this type of investment. Similarly, younger pensioners and people in their fifties can take advantage of the tax rules which allow money to be invested and withdrawn almost immediately after receiving the tax advantages. Contributions will receive tax relief at the contributor's highest rate and, if the individual is over the age of fifty, he or she can cash in their stakeholder pension at any time after this. This involves taking up to 25% of the total invested as a tax-free lump sum; the remainder must be used to purchase an annuity before the age of 75. Despite the current low rates of annuities, some accountants are reported to be advising pensioners to take advantage of these rules which will effectively enable them to receive large amounts of tax relief on savings which may only be invested for a few days.[34]

The government has stressed that the "target group" is not the same as the "market group" and the policy should be judged against its original target group.[35] The extension of the market group has resulted from the flexibility of the tax regime which is intended to ensure that a stakeholder pension is "a worthwhile, friendly and mass market product".[36] This should not lessen its appropriateness for those in the target group. The government does not have an explicit target for take up within the group though in a written answer in April 2000, Jeff Rooker, then Pensions Minister, confirmed that there are approximately 5 million people in the target group who do not have an occupational pension some of whom may already have personal pensions and therefore may be unlikely to take out a stakeholder pension.[37] The Green Paper estimated that of the 5.3 million with moderate earnings who do not have access to an occupational pension, 2.5 million contribute to a personal pension and 1 million are in a personal pension but only pay in their National Insurance rebate and make no additional savings of their own.[38] The government expects

---

[33] "Stakeholder – here at last", *Pensions Today*, May 2001

[34] "Cash in on new pension loophole", *Sunday Times*, 8 April 2001

[35] 8th SCDL 13 July 2000 c 21 – Jeff Rooker, then Minister of State at the DSS.

[36] Ibid c 18

[37] HC Deb 3 April 2000 c 337W

[38] Cm 4179, December 1998, p 49

that "take up will depend on how stakeholder and other pensions are marketed by providers, and on individual choices by savers".[39]

E. Compulsion?

This raises the question of what action the government may take if savers' individual choices do not result in a large take up of private pensions amongst the target group. The stated aim of the government's overall pension policy is to change the current ratio of state to private provision from the current 60:40 to 40:60 by 2050.[40] This clearly relies on an increase in funded provision by what the government describe as moderate earners. Some argue that the government's objectives will not be met without some element of compulsion on moderate earners to take out private pension provision. The government considered this during its pension review shortly after taking office in 1997. In the Green Paper published in 1998, it rejected this proposal arguing that increasing the amount of compulsion in the system would not benefit those who could least afford to save.[41] However, critics have pointed to the fact that a reference at the end of the Green Paper to "compulsory funded pensions for those earnings over £9,000 a year", presumably from an earlier draft of the paper, suggests that compulsory stakeholder pensions were only rejected at a relatively late stage.[42] It is certainly an issue which continues to dominate much discussion about stakeholder pensions but is one which needs to be seen in the wider context of the other parts of the pension system.

There is already compulsion for some people to save for either a state or private pension paid in addition to the basic state pension. The debate is therefore not about introducing an element of compulsion into the system but about extending the existing level of compulsion. Importantly, it is also about the question of compelling individuals to save through a private pension and taking on the risks that such saving involves. The compulsion which currently exists applies to employed earners earning above the National Insurance lower earnings limit who automatically accrue rights through their National Insurance Contributions (NICs) to the additional pension paid by the state, SERPS. They can choose to contract out of SERPS but one of the conditions of contracting out is that at least the difference between the contracted-in and contracted-out levels of NICs is paid into a private pension scheme.[43] The self-employed are not compelled to save for a second-tier pension (paid in addition to the basic state pension); they cannot accrue rights to SERPS and therefore cannot contract out.

---

39 HC Deb 3 April 2000 c 337W

40 DSS, *A new contract for welfare: a partnership in pensions*, Cm 4179, December 1998, p 8

41 Ibid, p 7

42 Ibid, p 105

43 When the State Second Pension replaces SERPS for rights accrued after April 2002, individuals will still be able to contract out in the same way.

Among others, the Association of British Insurers has called for greater compulsion on low to middle earners to take out stakeholder pensions.[44] They argue that not all providers will aim at the government's intended target group and the exemption of employer access for those who work for small firms will reduce take up. Also, the existence of a means-tested safety net for pensioners means there is little incentive for those on low incomes to save for their retirement. Furthermore, some argue that "people paid in the £10,000-£20,000 a year range … have other more pressing financial needs to satisfy out of their narrow resources".[45] These factors have led some, including spokespeople for both main opposition parties, to suggest that, under current policies, compulsion on moderate earners to save in a private pension will be inevitable if the government is to meet its objectives. Steve Webb, Liberal Democrat spokesperson, has pointed to the advantages of compulsion arguing that the market would expand and the resulting economies of scale would reduce costs without having to involve employers in the access arrangements.[46] The Liberal Democrat Manifesto for the 2001 election states that the party would introduce "a new universal compulsory and personal owned second pension account".[47] The proposals in the Conservative Party Manifesto would have extended funded provision by giving people the opportunity to opt out of the basic state pension but it rejected any further compulsion.[48]

The government maintains that there are no current plans to make stakeholder pensions compulsory. Jeff Rooker, then Pensions Minister, addressed this issue during the Standing Committee Debate on the main stakeholder pension regulations:

> We have no plans to make stakeholder pensions compulsory. The system of funded pension arrangements in this country is remarkable - £900 billion worth of people's savings and investments has been accumulated. This is not because the House passed a law saying that it would happen; it happened on a voluntary basis. The starting point of our overall policy is to get the target group into funded pensions. In due course there will have to be an assessment of how successful we have been in achieving that.[49]

Mr Rooker was also reported to have referred to a review of the success of current policies at an industry seminar in December 2000 and his comments have been interpreted as an indication that the government is considering compulsion if the voluntary approach does not work.[50]

---

44 "Insurance body urges compulsion for new pensions", *Financial Times*, 4 February 2000
45 "Stakeholder – here at last", *Pensions Today*, May 2001
46 8th SCDL 13 July 2000 c 12
47 p 9
48 p 24
49 8th SCDL 13 July 2000 c 23-4
50 "Hint of compulsion if stakeholders flop", *Times*, 13 December 2000

The main problem for any government considering an extension to compulsory pension savings is that it may be seen as a form of tax. Such a proposal is also likely to be controversial because it would involve the compulsory shift of second tier pension provision from the state to the private sector for those in the target group. Some critics point to the dangers of a continued shift towards funded provision which, while potentially a useful innovation, should not come at the price of exposing future pensioners to an unacceptable degree of individual risk. These risks have been highlighted in recent months by the events at Equitable Life which have led to significant cuts in the value of pension funds held by some individual investors. Will Hutton of the Industrial Society advocates an improved state pension which would provide an element of certainty and security for future pensioners. Funded pensions could then be taken out but with a safety net in place and such policies would presumably preclude the need for compulsion.[51] There are also more general arguments against compulsory pension saving, often made by libertarians opposed to state interference in what they argue should remain individual choices. They point to the fact that compulsory private pension savings have mainly been introduced in countries with relatively authoritarian political regimes such as Chile.

Others argue that further compulsion is not wrong in itself but would have to be combined with changes to the state system. For example, the Institute of Public Policy Research (IPPR) has proposed significant increases to the basic state pension, possibly as a preparation for compulsory funded second pensions.[52] Frank Field MP, former Minster for Welfare Reform, also supports more compulsory saving but rejects the introduction of compulsion to moderate earners under the current stakeholder system because it would involve insufficient redistribution. His own proposals combine the National Insurance pay-as-you-go scheme with a funded scheme and involve a state backed guarantee.[53]

The question of whether those in the target group should be compelled to save through a stakeholder pension is therefore a complex one with broader implications than those immediately suggested by the government's original policy to introduce a new form of low cost private pension. However, although the issues go beyond stakeholder pensions, the level of take up by those in the target group is likely to influence the extent to which this debate continues in relation to the UK pension system.

IV Early take-up figures and survey evidence

Detailed evidence of the extent of take up by the target group may take some time to emerge. Scheme administrators are required to make annual returns to the Inland Revenue, including information such as the net relevant earnings of policyholders, by the

---

[51] " An inequitable pensions policy", Financial Times, 10 January 2001; see also the Industrial Society Report, *Pension tension: how to reform Britain's pension system*, April 2001 - this contains detailed policy recommendations.

[52] IPPR, *A new contract for retirement: an interim report*, August 2001, p 14

[53] "A guarantee to end pensioner poverty", *Financial Times*, 3 August 2000; "Unwise to make stakeholder pensions compulsory", *Financial Times*, 1 March 2001

5th October following the end of the income tax year to which the notice relates.[54] This suggests that survey evidence may provide the main indicator of take up until after 5 October 2002 when the Inland Revenue has received most of the annual returns for 2001/02.

The government has stated that it has established a programme of dedicated research and analyses of administrative and statistical information.[55] For example, questions on stakeholder pensions will be included in the ONS' General Household Survey and in the Family Resources Survey published by the Department for Work and Pensions. Some limited data has been collected to date and this has provided figures on the number of sales in the first three months that stakeholders have been available. Surveys have also provided evidence of the extent to which employers are prepared for the introduction of the employer access provisions in October 2001. Other publications have examined the main features of the stakeholder pension products registered to date.

On 13 August 2001, the Association of British Insurers (ABI) announced that 224,506 stakeholder pensions were sold in the first three months since they were made available for sale in April 2001.[56] Press articles have estimated that nearly 175,000 of these sales were transfers from other policies suggesting net new sales of about 50,000.[57] The ABI has described this "as an encouraging start" while others in the industry are quoted as saying that the market is relatively static and sales have not been as good as were hoped. In fact, it is probably too early to draw too many conclusions from these early returns especially given that there is little information available on the people buying stakeholder products. Speculation that the majority of people buying stakeholders are not in the target group and are wealthier people using the products for tax planning purposes cannot be confirmed or disproved on the basis of the available information. There is some evidence however, that providers are targeting their stakeholder products at higher earners. A survey of the 47 registered schemes in August 2001 showed that, within the minimum standards, providers are offering a range of charges which reduce for the most affluent customers who make higher contributions.[58]

Earlier research by the ABI on attitudes to stakeholder pensions have suggested a fairly high awareness of stakeholder pensions. The ABI commissioned a market research company to ask a series of questions about stakeholder pensions to a sample of 962 individuals in the days immediately after the launch. The responses suggested that up to 1.5 million individuals may take out a stakeholder pension in the first year but the published research acknowledges that such estimates should be treated with a large

---

[54] Inland Revenue, *Personal Pension Scheme Guidance Notes (including Stakeholder Pensions) (2000)*, para 17.33

[55] HC Deb 9 July 2001 c 372W

[56] ABI news release, *90,000 employers designated stakeholder pensions by 30 June*, 13 August 2001

[57] "Slow start for stakeholder pensions increases pressure for compulsion", *Financial Times*, 14 August 2001

[58] "Cherry-picking is rife among some providers", *Occupational Pensions*, August 2001

degree of caution particularly given the difficulty of predicting how statements of intent will translate into actual behaviour. The estimate is also based on a range of other assumptions and should be seen as a guide to the possible magnitude of sales rather than a specific forecast. On the basis of the research findings, the ABI concludes:

> Stakeholder pensions have generated interest amongst all interest groups – around one third of those likely to take out a stakeholder pension have moderate incomes.[59] However, a considerable proportion of the stakeholder pension market may be either supplementing or replacing existing pension provision. It is yet to be proved that the introduction of stakeholder pensions will encourage significant numbers of new savers.[60]

The government hopes that the employer access arrangements will increase take up. This would appear to be borne out by the ABI research which found that a significant minority of employees would be more likely to consider taking out a stakeholder pension if it were arranged through an employer. The ABI research also concluded that any increase in take up that this generates is also likely to be complemented by an increase in awareness resulting from employer access, both through workplace discussion and a potential increase in advertising by providers.[61] However, there are some doubts that employers are prepared for the 8 October deadline. Despite DWP research which shows that over 90% of employers are aware of their responsibilities under stakeholder pensions, there is some evidence that many companies have yet to make the necessary arrangements. The ABI reported that nearly 90,000 employers had designated a stakeholder scheme by 30 June 2001.[62] According to the RIA, approximately 400,000 businesses have five or more employees and therefore may need to comply with the stakeholder pension access requirements. However, it is not clear exactly how many of these will need to comply with the employer access requirements. Some employers will have qualifying occupational pensions or group personal pension plans. There are approximately 105,000 occupational pension schemes but without examining the rules of each scheme it is not possible to state definitively how many of these would exempt the employer from the stakeholder requirements. There is no central register of group personal pension plans.

An article in the *Financial Times* on 7 August 2001 quoted a representative of OPRA who stated that the regulator would not be looking to impose fines in the first instance and would try to impose further deadlines on companies which had failed to register a scheme by 8 October 2001. The article also referred to research carried out by the pensions company Virgin Direct:

---

[59] The ABI survey defines "moderate incomes" slightly differently from the government definition for the purposes of its target group: £9,000 to £18,500 compared to the £9,000 to £20,000 used in the Green Paper.

[60] ABI, *The prospects for stakeholder pensions: a research report*, July 2001, p 3

[61] p 24

[62] ABI news release, *90,000 employers designated stakeholder pensions by 30 June*, 13 August 2001

> Nick Edmans at Opra said: "There will be significant non-compliance to start with . . . and there will be people who resist it to the bitter end." He put this down to the fact that many employers thought setting up a scheme was more time-consuming than it really was.
>
> Opra insisted it would not fine all late businesses the maximum £50,000. "This is not about raising fee revenue," said Mr Edmans. If a company missed the deadline but was trying to set up a scheme, the regulator would set a deadline, instead of imposing a penalty.
>
> Opra expects to discover tardy companies by hearing from their employees rather than by actively looking for late businesses. "We will rely on whistleblowers."
>
> Small businesses were most at risk of missing the deadline, Virgin said. Twenty-two per cent of groups employing five to 10 people plan to leave it till the last minute - double the average figure.
>
> The Federation of Small Businesses said it was pressing the government to delay fines for companies with fewer than 50 employees.[63]

V The search for a consensus on pension policy

A. Introduction

The European Commission adopted a Communication in July 2001 which addresses the issue of sustainable pensions policy in the context of demographic changes, such as an ageing population, and the importance of other policy goals, such as maintaining sound public finances and intergenerational equity.[64] It highlights the challenges to most European pension systems and warns that, in the absence of appropriate reforms, these challenges risk destabilising public finances or over-burdening the economy. The document recognises that pension policy remains within the remit of individual Member States. However, it offers some guiding principles for reform, one of which is that any reforms are the product of a necessary consensus of the wide range of interests involved and that all relevant actors are involved and committed to change.

The UK is generally considered to be in a strong position relative to its EC partners in terms of the issues addressed in the Commission Communication. This is partly due to the less developed systems of funded private pension provision outside the UK and the relatively less generous state provision in the UK compared to other EU member states. Also, the problem of an ageing population and an increasing ratio of pensioners to working population, the so-called "pensions time bomb", is more pronounced in most other EU member states than in the UK.

---

[63] "Businesses risk penalty over pension compliance", *Financial Times*, 7 August 2001

[64] European Commission, *Supporting national strategies for safe and sustainable pensions through an integrated approach,* COM(2001) 362, July 2001

However, while the UK has developed an apparently sustainable pension system, it is less clear that this has been achieved with the level of consensus that the EU suggests is important. This may simply be a reflection of a different type of policy formation in other European countries. Continental constitutional frameworks may make radical reform more difficult and encourage more consensual politics; the system of parliamentary government in the UK arguably allows more radical changes to be pushed through if a government has a sufficient majority. However, pension policy would appear to be one area where opposing parliamentary parties in the UK have acknowledged the importance of continuity and a broad consensus.[65] Whether such a consensus has been achieved is open to question. Pension policy since 1945 has been characterised by frequent attempts to overhaul the pre-existing system which, when successful, have often been revised years later usually following a change in government. The current government's attempts to achieve what the Institute of Public Policy Research (IPPR) describes as a pension "settlement", of which stakeholder pensions are an important part, can be seen as the latest example of such reform. It remains to be seen whether the new system survives in the long-term but it raises the question of whether a long-term political consensus is as essential as the European Commission suggests and what the implications are of a failure to achieve such a consensus.

It is an inherent feature of pensions policy that its effects are often not felt for decades after its implementation. Future rights to a pension build up during an individual's working life and his/her income in retirement will depend to a large extent on the policies in place many years previously. This creates two broad constituencies and interest groups: those who have already retired and those who are currently working and saving for their retirement. It is a generally accepted principle of pension policy that rights already accrued are protected on the grounds that it would be politically unsustainable to reduce rights which individuals have been led to expect and on which they have based their future plans. This means that changes to policy and legislation, whether improvements or, more commonly in recent years, measures which cut back on future provision to control public expenditure, are rarely retrospective.

However, this also makes comprehensive reform difficult. The costs of wholesale reform become unsustainable because of what public policy analysts describe as path dependency or "lock in": the set-up costs of establishing a new system are greater than the benefits of such a change.[66] This tends to mean that the primary determinant of policy is what is already in place: starting again from scratch is rarely viable with most

[65] For example, the Pension Provision Group Report commissioned by the DSS in 1998 describes one of the Secretary of State's challenges for the pensions review as achieving "a sustainable consensus on pension policy so people can properly plan for the future". (p 3)

[66] The most often quoted example of path dependency is the QWERTY keyboard. Originally developed with the aim of separating keys and preventing jamming, this layout is no longer necessary since the development of electronic typewriters and computers. However, the keyboard layout has been maintained because the set up costs of a new system are perceived to be too high.

developed policies; it has generally been considered to be impossible with pension reforms.[67] Thus changes generally constitute a supplement to existing provision which can often lead to complexity as new initiatives and developments are added to rights which have already accrued and are protected. UK pension policy since 1945 is a good example of this phenomenon and a brief history of pension policy in this period illustrates the development of the current system and the effect of previous policies.

B. Development of the current pension framework since 1946

The Beveridge scheme introduced by the post-war Labour Government in 1946 was based on National Insurance Contributions and a flat-rate pension paid in retirement. By the 1960s, there was general agreement that flat-rate state pensions were too low to prevent widespread poverty in old age. However, there was little agreement about how to provide and fund more generous provision. Boyd-Carpenter's graduated pension scheme of 1961 did not stop demands for further reform and a number of attempts were proposed under Labour and Conservative governments but were not implemented.[68] The *Social Security (Pensions) Act 1975*, which introduced the State Earnings Related Pension Scheme (SERPS), was the third attempt in six years to overhaul the system and the first to be implemented. Rights to SERPS began to accrue from April 1978. The public-private partnership central to today's system was also established: those who did not wish to remain in SERPS could contract out into an occupational pension.

However, although the 1975 Act was passed with all party support, in the mid 1980s the Conservative government began to reassess SERPS during its review of the social security system. This review was part of that government's general policy to reduce the level of social security expenditure. It had already taken steps to reduce pension expenditure most notably through the *Social Security Act 1980* which, among other things, limited the up-rating of long-term benefits to changes in price levels only, breaking the previous link with earnings. However, the review was also a response to growing concern about the cost of the scheme into the next century when the rising proportion of elderly people in the population would add to the emerging cost of pensions as the scheme approached maturity. At the same time, reducing the level of benefits offered by the state scheme would make room for private alternatives favoured by the Government: occupational and personal pension schemes. Therefore, in addition to measures to reduce SERPS, many of which have only recently started to take effect, the *Social Security Act 1986*, which resulted from the review, introduced new approved personal pensions. The new personal pensions were to be fully portable and capable of making and receiving transfer payments from other approved personal and occupational schemes. For the first time it was to be possible to contract out of the SERPS and use the contracted-out contributions

---

[67] See for example, DSS, *A new contract for welfare: partnership in pensions*, Cm 4179, December 1998, para 36

[68] see, for example, schemes proposed by Richard Crossman and Keith Joseph.

to fund an approved personal pension. Previously, it had only been possible to contract out using an approved occupational scheme.

Personal pensions which could be held independently of an employer were designed to be particularly suitable for the self-employed and those who moved jobs frequently, thus reflecting the Conservative government's policy of encouraging mobility of labour. They are generally considered to be unsuitable for those who have the option of an occupational scheme as the final benefits from a personal plan are likely to be less. There are three main reasons for this: the commission costs and charges payable on a personal pension plan; the fact that employers are more likely to contribute to an occupational scheme; and the structure of a final salary occupational scheme. By 1994, over 5 million personal pensions had been sold and by the early 1990s, stories started to emerge that many personal pensions had been sold to investors who would have been better off remaining in, or opting into, an available occupational scheme. Where such investments had been made on the advice of financial services firms this was termed mis-selling and a review was instigated which aimed to restore the financial position of those who had been mis-sold a personal pension.

The net effect of these policies to 1997 is difficult to summarise. From a public expenditure perspective it is clear that the encouragement of private pension provision and the measures to reduce state pension provision have put the UK government in a far stronger position than other European countries, many of which have pension systems which continue to rely heavily on state funded pay-as-you-go pensions. Projected public spending on pensions is predicted to peak at a far lower percentage of national income in the UK than in most other EU countries: an estimated 5.5% by 2030 compared to at least an estimated 14% in Germany and France by 2040.[69] The 1998 Green Paper also notes that average pensioner incomes have risen faster than the average incomes of those in work over the last 30 years. However, it also points to the large numbers of pensioners living in relative poverty, the reduction in state pension income as a result of cuts to SERPS and the removal of the earnings link which particularly affect poorer pensioners, increased complexity, and a loss of faith in the private pension system as a result of pension mis-selling and the Maxwell affair.

The complexity of the system is well documented and is partly a result of the regular reviews and additions to the pre-existing pension frameworks over the last fifty years. By implication, it is a result of the failure to achieve a long-term consensus in pension policy. The advice service OPAS reported in its latest annual report an increase of 21% in calls to its help-line and strongly criticises the complexity of pensions legislation.[70] For example, somebody retiring in the next few years may receive a total income made up of basic state pension, a small amount of graduated pension, SERPS and possibly income from a private pension. Similarly changes to pension policy can make planning for retirement

[69] "Protecting pensions", *Financial Times*, 21 May 2001
[70] OPAS, *Helping people through the pensions maze – a review of OPAS cases 2000/01*, 2001

more difficult. SERPS was designed to mature over an individual's full working life but changes to the scheme meant that it has never paid the level of benefits proposed by the original legislation.

C. Current government policy: a new pension settlement?

The present government appears to have accepted many of the principles of pension policy established in the 1980s, particularly the emphasis on private provision and individual savings. However, there is little evidence of a new consensus or a reduction in complexity. While retaining some of the policies of its predecessor, the government has introduced a range of reforms and intends to introduce more legislation in this parliamentary session.

The present government has resisted calls to restore the link between the increase in average earnings and the increase in the basic state pension, and has retained the reduction to the value of SERPS resulting from measures in the *Social Security Act 1986* and the *Pensions Act 1995*. The government has, like its predecessor, based much of its pension policy around private pensions, with stakeholder pensions the central element of this. It believes its policies will increase total pensioner incomes in the future, mainly fuelled by rising private contributions: the net effect of its policies is to increase further the proportion of pensioner income from private provision. However, this consensus does not extend beyond these apparent areas of agreement.

The government argues in the Green Paper that there are problems affecting both main constituencies with an interest in pension policy. Despite the increase in pensioner average incomes, many current pensioners are retiring in poverty. Furthermore, despite the advances in the 1980s, not enough people currently working are making private provision for their retirement. It has therefore adopted policies to increase the incomes of the poorest pensioners, through the means-tested Minimum Income Guarantee (MIG), while introducing measures which encourage those currently working to save more for their retirement. This has been described as a "paradox":

> There is a paradox at the heart of government pensions policy, namely that it wants more people to save and that at the same time wants to improve the situation of the less well off in retirement by increasing means-tested benefits. This makes it highly likely that those who save for retirement will disqualify themselves from means-tested benefits in their old age. As the target market for stakeholder pensions, by the government's own admission, is low and moderate earners, it is therefore questionable whether people in this group would be better off to save in a pensions vehicle rather than an individual savings account.[71]

The government's main response to these sort of criticisms has been the proposed pension credit which it proposes to introduce from April 2003. However, the IPPR argues that

this policy "raises other questions", most notably the increase in the proportion of people whose income will be means-tested in retirement. The IPPR also casts doubt on the ability of stakeholder pensions to reach the intended target group. In making these criticisms the IPPR suggests that the start of a second term for the government provides an opportunity to step back and review pensions policy. It questions whether the government's 1998 review has resulted in a long-term pension settlement. Similarly, the main parties seem far from reaching a consensus. Both the major opposition parties proposed further and different reforms of pension policy in their manifestos for the 2001 General Election: the Conservative Party proposed allowing people to opt out of the basic state pension; the Liberal Democrats proposed increasing the basic state pension and introducing greater compulsion for people to save for their retirement. There is little evidence of a consensus on questions such as the role and extent of means-testing; the balance between private and public provision; and the relevance, if any, of the contributory principle.

However, it is open to question whether this apparent lack of a long-term consensus really matters or indeed whether the differences between the major parties are about details rather than fundamental principle. Stakeholder pensions are unlikely to be abolished by a future government. The main political parties have acknowledged the importance of a degree of continuity in the regulation of private pensions and all appear to agree on the importance of this type of provision. However, the role that stakeholders will play in future pension provision is far from clear. They may become, as the government hopes, a major part of private pension provision for those on low incomes. Alternatively, they may, as some of the government's critics argue, simply provide an additional tax efficient savings vehicle for those who are already making provision for their retirement and make little difference to the future balance of public and private provision. The IPPR describes the stakeholder pension as a simple concept which has been launched into a complex environment. The prospects for a simplification of this environment will depend on the extent to which future governments support the pension framework which has developed since 1946 and which the government's current reforms will change further.

The incremental and changing approach to UK pension policy over the last fifty years may not appear to conform to the principles of consensus building set out by the European Commission. Some will point out that the UK system appears significantly more sustainable than that in most other European countries which have tried to progress on a consensual basis but which have failed to achieve radical reform. Others may point to a degree of complacency with the UK system and the danger of a type of "planning blight" caused by increasing complexity and an inability to rely on the pension policy of future governments. Pension systems take many years to mature. It remains to be seen whether the present government's proposals for a framework comprising a mixture of state and private provision through the state second pension, the pension credit, and personal, occupational and stakeholder pensions, will still exist in the form proposed in decades to come. While it is clear that stakeholder pensions will have a role in future

[71] "Cherry-picking is rife among providers", *Occupational Pensions*, August 2001

pension policy, the history of post-war pension policy and the apparent lack of political consensus suggest that the extent of that role remains far from certain.

VI Further reading

A. General information

There is a wide range of organisations providing information about stakeholder pensions for consumers, employers and providers. OPRA maintains a register of stakeholder pension schemes on its Internet site and this also contains general information.[72] The DSS has produced a leaflet for people planning for their retirement, *Stakeholder pensions – your guide* (leaflet PM8 December 2000). The Office of the Pensions Advisory Service (OPAS) is running a stakeholder pensions telephone helpline, funded by the DSS and the FSA, for people interested in taking out a stakeholder pension. The number is 0845 601 2923 and is open between Monday and Friday 8.30am – 6.30pm. The FSA has also published information for consumers on its Internet site including a consumer factsheet and an interactive version of the decision trees.[73] This includes projections of the estimated monthly stakeholder pension, at today's prices, which an individual may receive based on various monthly contributions at different ages.

B. Government consultation documents

With the exception of document 1, the DSS (now DWP) consultation documents listed in this section are available from http://www.dss.gov.uk/publications/index.htm. Hard copies of each document are available in the House of Commons Library.

1. DSS, *Stakeholder pensions: a consultation document*, November 1997

2. DSS, *A new contract for welfare: partnership in pensions*, Cm 4179, December 1998, Chapter 7

3. DSS and HM Treasury, *Flexibility in pension investment: helping to deliver stakeholder pensions*, 1 February 1999 (see http://www.hm-treasury.gov.uk/pub/html/reg/pens.pdf)

4. DSS, *Stakeholder pension: minimum standards - the Government's proposals*, Consultation Brief 1, 2 June 1999

5. DSS, *Stakeholder pensions: employer access - the Government's proposals*, Consultation Brief 2, 29 June 1999

6. DSS, *Stakeholder pensions: clearing arrangements - the Government's proposals*, Consultation Brief 3, 12 July 1999

---

72 http://stakeholder.opra.gov.uk
73 http://www.fsa.gov.uk/consumer/decision_trees/index.html

7. DSS, *Stakeholder pensions: regulation, advice and information – the Government's proposals*, Consultation Brief 4, 2 August 1999

8. DSS, *Stakeholder pensions: governance – the Government's proposals*, Consultation Brief 5, 2 August 1999

9. DSS, *Stakeholder pensions: the tax regime – the government's proposals*, Consultation Brief 6, 16 September 1999

10. DSS and Inland Revenue, *Details of the tax regime and draft Finance Bill clauses*, 22 February 2000 (see http://www.inlandrevenue.gov.uk/consult/stakeholderclausesconsultation.pdf)

11. DSS, *Stakeholder pensions: summary of responses to the government's proposals*, 10 March 2000

12. DSS, *Stakeholder pensions, Consultation on draft regulations*, 10 March 2000

13. FSA, *The FSA's approach to the regulation of the conduct of stakeholder pensions business*, May 2000 (see http://www.fsa.gov.uk/pubs/discussion/dp3.pdf)

14. FSA, *The regulation of stakeholder pensions*, FSA consultation paper 61, August 2000 (see http://www.fsa.gov.uk/pubs/cp/61/index.html)

C. Other reading

The Pension Provision Group, *We all need pensions – the prospects for pension provision*, 1998

Industrial Society Report, *Pension tension: how to reform Britain's pension system*, April 2001

European Commission, *Supporting national strategies for safe and sustainable pensions through an integrated approach,* COM(2001) 362, July 2001

Association of British Insurers, *The prospects for stakeholder pensions: a research report*, July 2001

Institute for Fiscal Studies, *Recent pensions policy and the pensions credit*, 2001

IPPR, *A new contract for retirement: an interim report*, August 2001 available from www.ippr.org.uk