These notes refer to the Welfare Reform and Pensions Act 1999 (c.30) which received Royal Assent on 11 November 1999

WELFARE REFORM AND PENSIONS ACT 1999

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Commentary

Section 1: meaning of "stakeholder pension scheme"

This section defines what a stakeholder pension scheme is. The definition:

enables stakeholder schemes to be accommodated within the existing legislative framework applying to occupational and personal pensions; and

sets out a number of additional requirements which schemes will have to meet in order to acquire stakeholder pension scheme "status".

The Pension Schemes Act 1993 currently defines two types of pension scheme – occupational pension schemes and personal pension schemes.

Subsection (1) provides for a pension scheme of either of these types to be a stakeholder scheme providing that it is registered as such (section 2 refers) and meets a number of specific conditions some of which can be prescribed in regulations.

Subsection (1)(b) provides a general power to prescribe other conditions which will give flexibility for the future to set out additional conditions, in the light of experience of operating schemes.

Subsection (2) requires stakeholder pension schemes to be set up under a trust (or an alternative arrangement specified in regulations).

Trusts are a legal concept used frequently as the basis for pension schemes, under which one or more persons (the trustees) hold property for the benefit of others, under terms which are usually specified in the trust deed. The regulation-making power will provide the flexibility to enable schemes to be run with alternative governance structures if these offer a comparable degree of protection for scheme members. The consultation document on the governance of stakeholder pension schemes proposed a possible model for "secure stakeholder management".

Subsection (3) provides a power to set out requirements as to the content of the instruments that set up a scheme. Taken together with subsection (2), this provides the basis for defining the structure of stakeholder pension schemes.

Regulations will be used to set requirements in relation to, for example:

the scope of the trust deed: in particular to ensure that the trust deed gives the trustees control of the scheme so that they are able to appoint and dismiss the organisations or individuals that provide services to the scheme (e.g. actuaries, auditors, administrators, investment managers);

the composition of the trustee board: to ensure, for example, that trustees associated with a commercial organisation (which may originally establish the scheme) cannot form a majority of the trustee board, or to require a specified proportion of the trustees to be nominated by members of the scheme;

whether the scheme should provide additional benefits for scheme members: such as an option to take out life assurance cover, or insurance which provides for contributions to continue to be paid if a member becomes ill or disabled.

If details of alternative forms of governance are prescribed under section 1(2) then it is intended that regulations will also be used to set out requirements as to the contents of instruments that set up such schemes.

Subsection (4) provides that schemes must offer "money purchase" benefits to members.

Money purchase benefits are defined in section 181 of the Pension Schemes Act 1993. The main impact will be to exclude schemes which provide benefits related to the member's final salary; unlike occupational pension schemes, there will generally be no organisation to provide the funding commitment required to run stakeholder pension schemes on a salary-related basis. Schemes operating on a money purchase basis must provide benefits which are related to the contributions paid by the members together with the investment returns on those contributions. This will mean that each scheme member would have an identifiable fund of money within the scheme, which is the sum of their contributions and investment returns on those contributions (less charges and expenses). The fund is normally used to purchase an annuity at retirement.

There is also a regulation-making power to prescribe exceptions. This power provides flexibility for the future by allowing the framework to be amended to accommodate schemes which may wish to offer benefits on a suitable alternative basis.

Subsection (5) provides a regulation-making power, which will be used to prescribe requirements in relation to the amount which may be deducted from scheme members' pension funds in respect of charges and expenses.

The regulations will set out how any charge is to be calculated, specify limits on the level of the charge, and specify when a charge can be imposed. For example, it is proposed in the consultation document on minimum standards that there will be no charge for transfer of funds into or out of stakeholder schemes or for changing contribution levels. Requirements for charges will be reviewed in the light of experience of operating schemes. Providing for these matters by regulation gives some flexibility for the future to amend the charging structure or limits if it becomes appropriate to do so.

Subsection (6) makes it a condition of being a stakeholder pension scheme that a scheme complies with the obligations under section 113 of the Pension Schemes Act 1993.

Regulations will set out minimum standards concerning, for example, annual information about:

the value of a pension,

the contributions that have been paid in; and

charges deducted by the schemes.

Subsection (7) provides that schemes must allow members to make contributions either on a regular basis or as and when they can; many existing personal pensions do not provide this flexibility for their members.

The subsection also provides a regulation-making power to prescribe minimum contribution levels, or other restrictions which schemes would be allowed to impose. Setting minimum contribution levels would be used to strike a balance between flexibility for members and the costs to schemes of handling very small contributions. The regulation-making power gives a degree of flexibility to vary these amounts in future if it becomes appropriate to do so.

Subsection (8) provides that stakeholder pension schemes should accept transfers of pension rights from other pension schemes.

Because stakeholder pension schemes will fall under the "pension scheme" definitions in Part I of the Pension Schemes Act 1993, members will have an automatic right to transfer their rights in a stakeholder scheme to another pension scheme (subject to certain limitations specified in the 1993 Act). This subsection provides an additional requirement on stakeholder schemes to *accept* transfer payments in respect of members' rights under other pension schemes and arrangements. It will allow members, for example, to consolidate their pension rights into a single fund if they so choose. There is currently no such requirement for occupational and personal pension schemes. But a stakeholder pension scheme would not be required to accept a transfer if this would prejudice its tax-approved or tax-exempt status. A tax-approved or tax-exempt scheme cannot accept transfers from an "unapproved" scheme, as this would be contrary to Inland Revenue rules.

Subsection (9) requires that a stakeholder pension scheme should be approved or exempted by the Commissioners of the Inland Revenue.

Approval or *exemption* confers a number of tax benefits: in particular, contributions by members qualify for income tax relief, and investment returns and capital gains on the scheme's funds are exempt from tax. Any particular provisions about the conditions for tax approval or the detail of the tax privileges will be dealt with in a future Finance Bill.