

Proposed changes to the eligibility rules for establishing a pension scheme

A consultation document

September 2005



HM TREASURY



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INTRODUCTION

1.1 This consultation document seeks views on proposed changes to:

1. the Financial Services and Markets Act (FSMA) Regulated Activities Order (RAO), to include a new regulated activity of setting up and running a personal pension scheme; and
2. the Finance Act 2004 (FA 2004), so that any person with permission to carry on this activity is eligible to establish a tax-privileged pension scheme.

1.2 The first part of this document details the Government's proposed changes and some alternative options. The second part is the partial Regulatory Impact Assessment. The third and final part contains drafts of the Orders which would amend the relevant legislation..

1.3 The tax rules for pension schemes are being reformed and simplified from 6 April 2006. As part of this process, the system under which new schemes are "approved" by Her Majesty's Revenue and Customs (HMRC) will be replaced by a system of on-line registration. Simplifying the establishment rules for pension providers would complement this more streamlined method of entry to the tax-privileged regime.

1.4 If, following responses to this consultation, a decision were taken to introduce the new regulated activity, the FSA would consult in April 2006 on the amendments to its rulebook that would be required to implement the change. Respondents may therefore wish to reserve detailed comments on the possible implementation of the new regulated activity until then, although we are of course happy to hear any views at this stage.

2

RESPONDING TO THE CONSULTATION

2.1 The Government would welcome responses to the issues and questions raised in this consultation document.

2.2 Please send responses to:

John McDonagh
Savings & Investment Products Team
HM Treasury
1 Horse Guards Road
London SW1A 2HQ
Email: john.mcdonagh@hm-treasury.x.gsi.gov.uk

to arrive no later than **23 December 2005**.

2.3 All responses received may be made public unless the sender indicates specifically to the contrary. General confidentiality disclaimers that often appear at the end of emails will be disregarded for this purpose.

2.4 Inquiries or comments about the consultation process should be sent to the same address.

2.5 The consultation will close on 23 December 2005.

3

PROPOSALS

3.1 To receive the generous tax relief afforded to pension savings in the UK, a pension scheme must have been established by an eligible person. The list of eligible persons (including firms) under the current tax regime is set out in section 632 of the Income and Corporation Taxes Act 1988. This list is replicated for the new simplified tax regime - which comes into effect from 6 April 2006 - in section 154 of the Finance Act 2004 (FA 2004). Under the simplified regime, tax-privileged pension schemes will be known as “registered pension schemes”.

3.2 The list includes insurance companies, unit trust scheme managers, operators, trustees or depositaries of recognised EEA collective investment schemes, building societies, banks and EEA investment portfolio managers (employers are separately eligible to establish occupational pension schemes).

3.3 Concerns have been raised that this list may be unduly restrictive. There may be firms that would like to operate pension schemes but are effectively prevented from doing so. This may lead to a reduction of competition and choice in the market.

3.4 Furthermore, there are some existing providers of Self-Invested Personal Pensions (SIPPs) who do not currently fall within the list of persons permitted to establish tax-privileged schemes. These providers have to operate through third parties who are within the list of eligible persons, which may place upward pressure on costs.

3.5 We would welcome responses on whether the current regime is indeed having this kind of effect.

The Options

3.6 In reviewing possible changes to the eligibility rules for establishing a pension scheme, the Government has considered the costs and benefits of pursuing a “Do Nothing” option.

3.7 Against this, the costs and benefits of three alternative options have been considered. These options represent broad choices whilst permitting discussion on some of the detailed points.

Option 1

Do Nothing

3.8 It is open to the Government to make no change to the legislation, and proceed with pension simplification on the basis of the establishment rules in FA 2004.

Option 2

Allow persons to establish registered pension schemes if they have permission to carry on an existing regulated activity that is related to investments

3.9 Extend the list of eligible persons by amending FA 2004 to allow any person having secured permission from the FSA to manage investments or to safeguard and administer investments to establish a registered pension scheme, with effect from 6 April 2006.

Option 3

Allow persons to establish registered pension schemes only if they have permission to carry on a regulated activity that is related to personal pension schemes

3.10 In April 2006 FSA consults on the rules required to implement a new regulated activity of establishing, operating or winding up a personal pension scheme, and on the consequential regulation of dealing in, arranging and advising on rights under such schemes.

3.11 Given a positive consultation response, the FSA makes rules for the new activity by October 2006. This should, allow sufficient time for persons to apply for permission to carry on the new activity s before the new rules come into force, and also allow existing providers time to adapt their internal systems and processes.

3.12 Before 6 April 2007, amend the Financial Services and Markets Act (FSMA) Regulated Activities Order (2001) to include a new regulated activity of establishing, operating or winding up a personal pension scheme. Then amend FA 2004 to make any person having secured this permission eligible to establish a registered pension scheme.

Option 4

Allow persons to establish registered pension schemes if they have permission to carry on an existing regulated activity that is related to investments, but only until 6 April 2007, whereafter they may do so only if they have permission to carry on a regulated activity that is related to personal pension schemes

3.13 Before April 2006 temporarily extend the list of eligible persons by amending FA 2004 to allow any person having secured permission from the FSA to manage investments or to safeguard and administer investments to establish a registered pension scheme. This temporary amendment would be effective from 6 April 2006 until 5 April 2007.

3.14 In April 2006 the FSA consults on the rules required to implement the new regulated activity of establishing, operating or winding up a personal pension scheme and on the consequential regulation of dealing in, arranging and advising on rights under such schemes.

3.15 Given a positive consultation response, the FSA makes rules for the new activity by October 2006, so allowing persons wishing to apply for permission to carry on the new regulated activity sufficient time to do so before the new rules come into force.

3.16 Before 6 April 2007 amend the Financial Services and Markets Act (FSMA) Regulated Activities Order (2001) to include a new regulated activity of establishing, operating or winding up a personal pension scheme. Then amend FA 2004 to make any person having secured this permission eligible to establish a tax-privileged pension scheme. Remove both the temporary references to existing permissions and the amended list of eligible persons.

Arguments

3.17 The introduction of a new regulated activity with associated amendments to the Finance Act, as described in Options 3 and 4, seems to have several advantages.

- It would bring about greater transparency. The new regulated activity would have a clear purpose, which industry and pension savers could easily understand. Regulation of pension savings would no longer have to be interpreted through other statutory provisions.
- Existence of the new regulated activity would give confidence to existing and prospective pension savers. Individuals would see that an operator¹ is authorised to manage and administer their pension investments, with recourse to the FSA if something goes wrong.

¹ The operator would be the person authorised by the FSA to carry on the regulated activity.

- Scheme members would have clear protection, as the professional operators of all types of personal pension schemes would be regulated by the FSA regardless of the type of investment that the scheme held (at present the protection afforded is partial depending, to a great extent, on the nature of the underlying investment).
- The new regulated activity would be comprehensive, embracing both the investment and management of pension savings and the administrative requirements placed on schemes by law as well as advice on the merits of joining any particular scheme regardless of the nature of the underlying investments.
- The market would be opened up - since those wishing to operate pension scheme assets would no longer have to belong to one of the specified categories of person or to hold any other FSA permissions. This should lead to greater competition and choice for consumers.
- The arrival of more providers in the market (particularly those with fund management and marketing expertise elsewhere in the financial services sector) could lead to product innovation, and greater customer choice.
- Some administrators (notably SIPP providers) who are outside the regulatory framework would no longer have to operate through insurance companies or other structures specified in the tax legislation. This would bring about cost savings in certain aspects of scheme operation, and lead to simplification of administration.

3.18 Option 2 also carries some of these advantages. However, a disadvantage of introducing this option is that providers offering schemes invested only in investments outside the scope of FSA regulation (for example cash or real property) would be ineligible to establish registered pension schemes if they did not have the required permissions. This would risk stifling innovation in the market. There would also appear to be a risk of further amendment to the regulations being required in future to deal with new developments.

3.19 There is also the risk of a lack of clarity and regulatory arbitrage, since some types of pension would be regulated by the FSA and others not. This distinction might be difficult for end consumers to understand.

Preferred Option

3.20 The Government's preferred option is therefore to introduce the new regulated activity as described under **Option 3**. To allow sufficient time for the FSA to conduct a thorough consultation on its rules, and then for companies to apply for authorisation or to vary their existing permissions, April 2007 seems to be the optimal date from which to introduce this.

3.21 The temporary amendment to FA 2004 detailed in Option 4 would allow those firms with permission from the FSA to manage investments or to safeguard and administer investments to establish a tax-privileged scheme from April 2006. The advantage of this approach is that it would open up the market to a greater number of firms at the earliest possible stage, before the implementation of more fundamental reform.

3.22 However, the Government recognises the potential regulatory turbulence caused by two consecutive amendments to FA 2004. The Government would therefore propose only to implement this temporary amendment if consultation responses indicate that the additional time would confer significant benefits on the market.

3.23 It should be noted that if a decision were taken to introduce the new regulated activity (e.g. through implementation of Option 3 (or 4) above), the existing regulated activity of establishing, operating or winding up a stakeholder pension scheme (set out in Article 52 of the RAO) would be extended to include those types of activities in relation to a personal pension scheme.

4

SCOPE AND BOUNDARIES OF THE PROPOSED NEW REGULATIONS

4.1 Investments currently outside of FSA regulation that would be brought within FSA regulation for the first time would be the rights that persons attain by virtue of being members of a personal pension scheme other than a stakeholder scheme (where the rights are already a specified investment). This would include, in particular, the right to receive sums determined by reference to the value or performance of the underlying property.

4.2 Some investments that would then be permitted under these pension schemes (for example cash and real property) are not currently regulated under FSMA. These investments would not, of themselves, be brought within the scope of FSA regulation.

4.3 But advice to contribute to a particular personal pension scheme would be advice to acquire rights under that scheme and would therefore be regulated advice. And dealing in, managing, safeguarding and administering or arranging for a person to acquire those rights would become a regulated activity.

4.4 What this would mean is that by introducing the new regulated activity, the buying or selling, or managing of real estate, for example, would not become an activity regulated by the FSA simply because the property is to be held under a personal pension scheme. So, for example, FSA regulation would not extend to any duty on the scheme operator to find tenants or collect rents in respect of a residential property.

4.5 But, subject to the results of the FSA's subsequent consultation on changes to its rulebook, FSA regulation would be likely to take in the operator's responsibility for ensuring that, for example, real estate investment (of, say, residential property), is carried out in the manner required by the instruments (or rules) governing the scheme.

4.6 Discretionary investment management services are already regulated by the FSA, and this extends to investment portfolios that include a mixture of regulated and non-regulated assets. Similarly, overall safeguarding and administering services are already regulated where there is a mixture of regulated and non-regulated assets.

Questions

4.7 Do you agree that the current eligibility rules may restrict entry to the personal pensions market and, for some providers, add to administrative costs?

4.8 Do you agree that the definition of persons eligible to establish a tax-privileged pension scheme should be changed?

4.9 Do you agree with the proposed approach of creating a new regulated activity (Options 3 and 4) or would you prefer that persons with permission to carry on certain existing regulated activities be made eligible under the Finance Act (Option 2)?

4.10 If you agree with the proposed approach of creating a new regulated activity, do you think that the benefits of implementing a temporary amendment to FA 2004 (as described in Option 4) would be sufficient to make it worthwhile?

4.11 If you would prefer to rely on existing regulated activities, do you agree that managing investments and safeguarding and administering investments are the right activities to choose?

4.12 The Government recognises that firms in the pensions industry have put in place significant programmes of change in preparation for the implementation of pensions tax simplification. Are there specific steps the Government should take to help firms integrate preparation for this change with finalising preparations for simplification?

4.13 Operating a scheme classified as an occupational scheme would not fall within the proposed new regulated activity. It is proposed to use the definition of an occupational scheme set out in Pensions Act 2004, but to remove the portion of that definition which excludes schemes with their main place of operation outside the UK. This is to avoid these types of schemes coming within FSA regulation as personal pension schemes. Do you agree with this approach?

4.14 Do you have any other comments on the proposed amendments?

4.15 Do you have any other comments on the costs and benefits detailed in the partial RIA?

5

PARTIAL REGULATORY IMPACT ASSESSMENT

I Proposal

1. Proposed changes to the Financial Services and Markets Act (FSMA) Regulated Activities Order (RAO), to include a new regulated activity of setting up and running a personal pension scheme; and the Finance Act 2004 (FA 2004)), so that any person with permission to carry on this activity is eligible to establish a tax-privileged pension scheme.

II Purpose and intended effect of the measure

Policy objectives

2. The objectives are essentially twofold:
 - a) to open up the personal pension market to a wider range of providers (a benefit for business), and
 - b) to make regulation of personal pension operators more transparent and comprehensive (a benefit for consumers).
3. It is anticipated that the first objective will have been achieved within five years of implementation. The second objective should be achieved from the point of implementation.
4. Although one proposed option involves the addition of a new form of regulation, the proposal would also entail the removal of restrictive and cumbersome statutory rules from tax law. Overall, therefore, the effect of these proposals would be de-regulatory.

Background

5. There is a general presumption that only suitably qualified or reputable “persons” (a term which includes financial institutions) should be allowed to manage pension savings. That is because of the large amounts of tax-relieved contributions going into pension schemes, and the extent to which individuals rely on their pensions to provide a secure income in retirement. Accordingly, tax law places restrictions on the type of person who may establish tax-privileged schemes.

6. These persons include:
- a) employers to establish occupational pension schemes for their employees'
 - b) insurance companies, banks, building societies, open-ended investment companies and managers of authorised unit trusts (including firms based in other countries in the European Economic Area (EEA)¹) to establish personal pension schemes for individual savers.²
7. What the second set of above persons have in common is that their commercial activities in the UK are subject to independent regulation by the Financial Services Authority (FSA). The regulation provides them with a “badge” of suitability, and acts as a qualification for entry to the tax-privileged regime. The entry rule reduces the risk that unsuitable persons will gain entry to the pensions market. But it is not clear from the face of the legislation that the eligible persons are specifically qualified to operate pension schemes.
8. The tax rules for pension schemes are being radically reformed from 6 April 2006 (A-Day). Most of the existing legislation governing the tax treatment of pension schemes is repealed from that date, and succeeded by new legislation contained in the FA 2004 (FA 2004)³. The various tax regimes for different types of pension scheme are swept away, and replaced by a single unified regime for all types of tax-privileged scheme. This process is known as pension simplification.
9. As a consequence of pension simplification, many of the tax distinctions between occupational pension schemes and personal pension schemes will disappear. It will no longer be necessary for new schemes to be formally “approved” by HM Revenue & Customs (HMRC) in order to obtain tax privileges. Instead, all tax-privileged schemes will be known as registered pension schemes. All existing approved schemes will automatically become registered schemes from A-Day (subject to an opt-out not being exercised).
10. However, the rules on who may establish a new tax-privileged scheme were not significantly changed in FA 2004⁴. The new rules largely replicate those currently in force.
11. **It is now proposed that the rules be rewritten - so that eligibility would no longer depend on belonging to a named category of person. Instead, any person with an appropriate permission from the FSA to carry on a regulated activity would become eligible to establish a new registered pension scheme in the UK.**
12. Activities regulated by the FSA are set out in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the RAO). Eligibility to establish a registered pension scheme could depend on having permission to carry on one of the existing regulated activities of “managing investments”, or “safeguarding and administering investments”. Alternatively, there could be a new regulated activity explicitly covering the establishment and operation of personal pension schemes, and eligibility under the tax rules could depend solely on having permission to carry on that activity.

¹ The EEA covers the European Union, plus Norway, Iceland and Liechtenstein.

² Section 632 of the Income and Corporation Taxes Act 1988

³ The FA 2004 legislation was supplemented by some further legislation in the Finance Act 2005.

⁴ The list of regulated persons entitled to establish a scheme now appears in section 154 FA 2004 (with section 155 defining certain terms used in section 154).

Rationale for change

13. The pensions market has changed over time - and is likely to change further in the future. Although most working people still rely primarily on occupational pensions to provide them with an income in retirement (about 10 million are currently members of occupational schemes), around 5 million others now contribute to personal or stakeholder pensions.
14. A large number of pension savers or providers may want to take advantage of the greater flexibility allowed under pension simplification, e.g.
 - a) a member of an occupational scheme may wish to start a personal pension scheme to top up the benefits due from the main scheme. The simplified tax regime, which applies a single (and generous) set of limits to all of an individual's pension savings, facilitates diversification of this sort.
 - b) an individual may wish to start a self-invested personal pension (SIPP), to secure a degree of control over his or her pension investments. Industry figures indicate that SIPPs still constitute only a small part of the market, with fewer than 200,000 participants. But there may be reason to expect a growth in the number of SIPPs after April 2006
 - c) small schemes may wish to invest pension savings in a wider range of assets than they are currently allowed. The aim must always be long-term growth, but certain types of asset may offer better prospects over twenty or thirty years than traditional share-based investments.
15. The vast majority of personal pension schemes are provided by insurance companies, but there are other potential providers who believe they are able to offer good quality pension products. Indeed, opening up the market to new providers would encourage innovation in product design, and increase choice and competition. This may in turn help to drive down costs.
16. However, the tax rules act as a barrier to new entrants to the market. A number of those who would like to establish pension schemes are not included in any of the categories listed in tax law. Those excluded include many fund managers, custodians⁵ and managers of investment trust companies, who are only able to establish new schemes by operating through institutions such as banks or insurance companies that are recognised in the legislation. Many SIPP operators (who are often trustees of their schemes) are also in that position.
17. There is another reason to consider change. As matters stand, even though the persons entitled to establish personal pension schemes are regulated by the FSA, that regulation does not extend to every aspect of operating a scheme, e.g.
 - a) the administration of a personal pension scheme (complying with tax and pensions legislation) is not covered by any existing regulated activity
 - b) there are also gaps in the FSA's regulation of investment activity. Although pension operators will generally have permission to carry on the regulated activity of managing investments, there are certain investments - such as cash, residential property and antiques - that are not covered by that permission. This means, for example, that a SIPP operator investing a client's contributions by purchasing a particular residential property is not regulated in respect of that investment, and the SIPP holder would have no statutory protection in the event of that investment going wrong.

⁵ Custodians are responsible for safeguarding assets and undertaking administrative tasks such as record-keeping, accounting, and liaison with HMRC.

18. The current tax rules allow HMRC to approve any pension scheme that is a trust-based stakeholder scheme⁶, irrespective of who establishes it. This provision is not replicated in the new rules – as, in practice, stakeholder schemes will generally be established by persons who are otherwise eligible under those rules. That slight restriction on eligibility removes the risk that unregulated persons could establish stakeholder schemes. There is an existing regulated activity of “establishing, operating or winding up a stakeholder pension scheme”.
19. **Persons setting up stakeholder schemes must have permission to carry on this activity. Accordingly, a link could be introduced in the tax rules between FSA regulation and eligibility to establish a stakeholder pension scheme that is also a personal pension scheme.**

III Options

20. In reviewing possible changes to the eligibility rules for establishing a pension scheme, the Government has considered the costs and benefits of pursuing a “Do Nothing” option. Against this, and in order to meet the policy objectives, the costs and benefits of three alternative options have been considered. These options represent broad choices whilst permitting discussion on some of the detailed points.

Option 1: Do Nothing

21. It is open to the Government to make no change to the legislation, and proceed with pension simplification on the basis of the establishment rules in FA 2004.
22. The advantage of this option is that there would be one change fewer for the pensions industry to deal with. Already, the industry has to implement changes brought about both under pension simplification and by the Pensions Act 2004 (which is DWP legislation). Adopting Option 1 would maintain the status quo in one area of the law affecting pension schemes.
23. The disadvantage of this option is that it would preserve the current restrictions on entry to the pensions market, and inhibit competition and product innovation. The pensions market may effectively remain closed to some people with relevant expertise. Moreover, as pension investments become more diverse (particularly in SIPPs), so an increasing range of pension investment activity (including the giving of certain advice) may fall outside the scope of FSA regulation. The degree of consumer protection may therefore be reduced, and opportunities for regulatory arbitrage may increase.

Option 2: Allow persons to establish registered pension schemes if they have permission to carry on an existing regulated activity that is related to investments

24. Under this option, any person with permission from the FSA to manage investments (under article 37 of the RAO) or safeguard and administer investments (article 40) would be eligible to establish a registered pension scheme from A-Day.
25. The existing list of eligible persons would be extended by the addition of those firms with FSA permission under articles 37 and/or 40 of the RAO. FA 2004 could additionally be amended so that any person with permission from the FSA to establish or operate a stakeholder scheme (article 52) would be eligible to establish a registered pension scheme that is also a stakeholder scheme.

⁶ Stakeholder schemes were launched in 2001 to encourage pension saving among employees who do not belong to an occupational scheme. Most are set up as personal pension schemes, and all are characterised by a limit on the fees that the provider can charge. “Stakeholder pension scheme” is defined in section 1 of the Welfare Reform and Pensions Act 1999.

26. Implementing this option would require an amendment to FA 2004⁷ (and some amendments to HMRC guidance) in early 2006, but no amendment to the RAO.
27. The main advantage of Option 2 is that it would open the pensions market to new providers without most having to take any action to obtain any further permission from the FSA. That is because persons wishing to establish pension schemes are likely to be permitted to carry on one or both of these regulated activities already. Providers would be authorised by tax law to establish pension schemes in much the same way that they are authorised to manage Individual Savings Accounts or Child Trust Funds.
28. The disadvantages of Option 2 are several. First, there would be no explicit link between the permitted activity and the operation of a pension scheme. Second, it could remain unclear that an eligible person had any particular expertise to deal with *all* aspects of operating a pension scheme (which requires specialist knowledge as well as competence with investments). Third, an investment manager or custodian operating a personal pension scheme would not be supervised by the FSA in respect of that particular activity. Fourth, neither the Financial Ombudsman Service (FOS) nor the Financial Services Compensation Scheme (FSCS) would be available to consumers in respect of such pension schemes. Last, this change in particular may encourage a large number of new pension operators each investing only in a limited range of funds, so leading to greater fragmentation of pension investments.
29. In addition, some investment activity (including the giving of advice on certain investments) would remain outside FSA regulation, so limiting consumer protection and perhaps inviting arbitrage between regulated and unregulated investments.

Option 3: Allow persons to establish registered pension schemes only if they have permission to carry on a regulated activity that is related to personal pension schemes

30. Under this option, a new regulated activity would be built on the existing activity relating to stakeholder schemes, so as to cover any other type of personal pension scheme. FA 2004 would then be amended⁸ to link with the existing and new activity. As a result, from 6 April 2007, a person seeking to establish a registered pension scheme would first require permission from the FSA to carry on either or both of the regulated activities of establishing, operating or winding up a stakeholder or a personal pension scheme.
31. Implementing this option would involve amending the RAO and then amending FA 2004. Implementation could not take place until April 2007, to allow time for the FSA to consult on the proposed changes. The FSA would publish a consultation paper in April 2006 and analyse feedback during the summer, with a view to making any agreed amendments to the RAO and the FSA rulebook by October 2006. This would allow around six months before April 2007 for the making and processing of applications for permission to carry on the new activity. HMRC would also need to amend its guidance on establishment of registered schemes.
32. Certain existing regulated activities would apply to rights acquired by members of personal pension schemes as a result of these two changes, e.g. giving advice on the merits of joining or of placing a specific investment in a particular personal pension scheme would become regulated by the FSA.
33. The chief advantages of Option 3 are: first, that it makes an explicit link between an activity regulated by the FSA and eligibility under tax law to commence that activity; and second, it is transparent – allowing regulatory cover to extend to all key aspects of operating a personal pension scheme (including the giving of advice).

⁷ This amendment can be made by Treasury Order under section 154(4) FA 2004.

⁸ As with Option B, the amendment can be made by Treasury Order under section 154(4) FA 2004.

34. The chief disadvantage of Option 3 is that reform would be delayed until twelve months after A-Day (so separating it from the main body of tax changes due under pension simplification). Furthermore, if persons already with permission to operate stakeholder schemes could have that permission quickly converted to cover the new regulated activity, this may give them a head-start in attracting new business over those applying for the first time to carry on a pension-related activity.

Option 4: Allow persons to establish registered pension schemes if they have permission to carry on an existing regulated activity that is related to investments, but only until 6 April 2007, whereafter they may do so only if they have permission to carry on a regulated activity that is related to personal pension schemes

35. Under this option any person with permission from the FSA to manage investments or safeguard and administer investments (and possibly also to establish or operate a stakeholder scheme) would be eligible to establish a registered pension scheme from A-Day until 5 April 2007. Thereafter the rules laid out under Option 3 (above) would apply i.e. a person would require permission from the FSA to carry on either or both of the regulated activities of establishing, operating or winding up a personal pension scheme or a stakeholder scheme in order to be eligible to establish a registered pension scheme.
36. Option 4 would also involve amending both the RAO and FA 2004, but in this case FA 2004 would need to be amended twice, with the first amendment having to be in place before April 2006.
37. Under Option 4, the RAO and the second FA 2004 amendment would be delayed until later in 2006. As with Option 3, the FSA would consult on the necessary amendments to its rulebook in April 2006, and then publish its final rules by October 2006. This would allow approximately six months for firms to apply for and obtain permission to carry on the new activity. As with Options 2 and 3, HMRC would need to amend its guidance.
38. Option 4 has a singular advantage over Option 3 in that it opens up the market twelve months earlier. In the short term, most of those wishing to establish schemes would not need to take any action as they are likely already to have the required permission.
39. The two disadvantages of Option 4 are: first, that it would involve a two-stage amendment to tax law, with two changes to the eligibility rules in the space of twelve months; and, second, there would be a year's delay after A-Day in bringing certain activities (including advice on the merits of acquiring rights related to particular SIPP investments) within the scope of FSA regulation.
40. Introduction of the new regulated activity under either Options 3 or 4 would make regulation by the FSA more explicit. There would be a better fit between regulation and tax law, and the pension saver would be more likely to have confidence in a person or firm that has specific permission to operate pension schemes (rather than the more general activities of managing investments, or safeguarding and administering investments).

IV Costs and benefits

Sectors and groups affected

41. Options 2, 3 and 4 will affect persons and firms in the financial services industry, in particular those currently operating personal pension schemes, and those who wish to be able to operate such schemes. The former are primarily insurance companies, but also include around eighty SIPP operators, most of which are small specialist firms. The latter could include a range of fund managers, investment trust companies and potentially other firms such as fund supermarkets and stockbrokers.

Benefits

Option 1

42. No benefits accrue to consumers as a result of pursuing Option 1 (Do Nothing), and existing persons of firms currently operating personal pension schemes will maintain their hold on the market.

Options 2, 3 and 4

43. By making eligibility to establish a registered pension scheme dependent only on having an appropriate permission from the FSA, the Government would help to open up the pensions market. Eligibility would depend not on having a particular legal form or structure, but on being authorised to carry on a particular activity. Any person who met the FSA's conditions would be able to establish a new scheme. In addition, opening up the pensions market may help to encourage greater overall take-up of pension saving by working people.
44. The following benefits that might therefore flow from Options 2,3 and 4:
- the market would be opened up - since those wishing to operate personal pension schemes would no longer have to belong to one of the specified categories of person. This would lead to greater competition, which may in turn help to drive down costs.
 - the arrival of more providers in the market (particularly those with fund management and marketing expertise elsewhere in the financial services sector) would lead to product innovation, and greater customer choice.
 - some providers (notably SIPP operators and investment trust managers) who are outside the current legislative framework would, if they were to obtain the appropriate permission, no longer have to operate through insurance companies or other structures specified in the tax legislation. Shedding such structures is likely to bring about cost savings (which may be offset against new costs), and lead to streamlining certain aspects of operating a scheme.
45. The following additional benefits would flow from Options 3 and 4:
- use of the new permission would bring about greater transparency. The new permission would have a clear purpose, which those in the industry, and pension savers, can easily understand. Regulation of pension savings would no longer have to be interpreted through other statutory provisions. Greater clarity should assist in the comparison of products and costs.
 - existence of the new permission would give confidence to existing and prospective pension savers. Individuals will see that the person who established and operates the scheme is authorised to manage and administer their *pension* investments, with recourse to the FSA if something goes wrong.
 - scheme members will have clear protection, as the professional operators of all types of personal pension schemes will be regulated by the FSA, regardless of the type of investment that the scheme holds.
 - the new regulated activity would be comprehensive, embracing both the investment and management of pension savings and the administrative requirements placed on schemes by law. Regulation would extend to a greater range of pension-related investment activities, including the merits of joining a particular scheme.
46. The chief benefit flowing from Option 4 would be the opening up of the market one year earlier than would be the case under Option 3.
47. The Government welcomes comments from respondents on the benefits of the proposals.

Costs

Option 1

48. No additional costs accrue to persons or firms in the financial services industry as a result of pursuing Option 1 (Do Nothing). Existing costs met by persons or firms ineligible to operate personal pension schemes would remain.

Option 2

49. Option 2 is likely to have no significant cost, because most persons wishing to move into the pensions market will already have one of the required permissions (or will continue to operate through such a person).

Options 3 and 4

50. The costs of obtaining permission for the proposed new regulated activity are likely to vary according to whether a person or firm:
- a) already has permission for the article 52 activity (establishing a stakeholder scheme)
 - b) does not have permission for the article 52 permission, but does have other permission for other regulated activities *and* is involved in pension provision
 - c) as above, but is *not* already involved in pension provision
 - d) has no existing permission to carry on a relevant regulated activity (i.e. is unauthorised).
51. As a general rule, those obtaining permission to carry on regulated activities would have to pay one-off fees to the FSA. The anticipated fees payable are explained below, but FSA charging policy is reviewed annually - and so the figures may change.
52. Additionally, there will be internal administrative costs to firms applying for the permission, although these may not be very significant. Firms new to pension provision are likely to incur costs of setting up new systems (including a compliance function), and the appointment and training of approved individuals. However, firms in the pensions industry will have to bear costs of this sort in any case, in order to adapt to the simplified tax regime from A-Day (which should deliver savings over time). The additional costs of obtaining permission for the new activity are likely to be relatively low.
53. With regard to the variances in costs:
- a) it is envisaged that any person with permission for the existing article 52 activity would not need to apply for the permission to carry on the new activity. If that is what transpires, the costs of obtaining permission for the new activity would be negligible for these persons
 - b) persons without permission for the article 52 activity, but who are already involved in the provision of personal pensions, will almost certainly already have permission to carry on relevant regulated activities. Such persons will typically be insurance companies. It is current FSA policy not to charge a fee for varying a permission where carrying on the new activity would not cause such a person to fall within a different “fee block.”⁹

⁹ FSA fees are generally set under a system of fee blocks, each block applying to a particular sector of the financial services industry. For example, there are separate fee blocks for deposit takers, life insurers and fund managers.

In other cases, there is currently a one-off charge for varying an existing permission of £2,500. The FSA would not expect to impose new capital adequacy requirements¹⁰ or additional annual fees or levies on these providers. However, the FSA expects to review whether any other change to the charging structure for varying permission is needed in respect of the new activity and will consult on any proposals

- c) those persons (such as fund managers) who wish to move into the pensions market would also need to obtain permission for the new activity. Persons in this position are likely already to have permission to carry on other regulated activities - such as Managing Investments (article 37) and Safeguarding and Administering Investments (article 40). The firm would have to meet the cost mentioned above of varying its permission if it is moving into a new FSA fee block as explained above. The business might also have to increase the value of its funds and assets in order to meet capital adequacy requirements
- d) a number of unauthorised persons may wish to obtain permission to carry on the new activity. These might include operators of SIPPs (who would typically be the trustees). For such persons, the costs of entering the field of regulated activity for the first time would be more substantial. The application fee (based on current rates) would range from £1,500 in straightforward cases and £5,000 in moderately complex cases, to £25,000 for the most complex firms. SIPP operators are likely to be in the middle of these categories.

Additional One Off Costs

- 54. Some persons in the above categories may also need to obtain permission to carry on other regulated activities – such as dealing in, arranging and advising on investments (Articles 14, 21, 25 and 53 of the RAO - which will be extended to cover personal pensions. In the large majority of cases, those wishing to carry on these activities would already have permissions that cover the activities (because they already arrange and advise on stakeholder pensions, or investments such as insurance policies and unit trusts). Where there is a charge for obtaining permission for one of these activities, it would be £2,500 (as for other variations to permissions).
- 55. In addition, there would be some stationery costs. The newly regulated person would be required under FSA rules to disclose the regulated status, meaning that the firm's headed letter paper (and perhaps other documentation) would have to be amended to show this.

Additional Ongoing Costs

- 56. There are also some ongoing costs. Any person who has obtained permission would have to pay a periodic fee each year to the FSA, and also levies to the FSCS and FOS: details of how these fees are structured can be found on the FSA website.
- 57. How fees for the new regulated activity might be structured will be addressed by the FSA through its own consultation process. One-off fees for fund managers could be either an authorisation fee for firms new to regulation by the FSA, or a fee for varying an existing firm's permissions. Additional ongoing FSA fees and FOS/FSCS levies would be incremental for existing firms, based mostly on a sliding scale related to the increase in the size of funds under management, or the total funds for firms new to FSA regulation.
- 58. Examples of total annual fees and levies that firms typically pay under the A7 fee block (which applies to fund managers – persons most likely to seek new permissions) are currently £2,500 for a small firm, £25,000 for a medium-sized firm and £250,000 for a large firm. These may be supplemented by some ongoing management costs of supervising approved individuals.

¹⁰ Capital adequacy requirements ensure that a firm's financial resources provide a suitable level of protection against the risks associated with its business activities.

59. A summary of possible FSA charges for a medium sized firm under Options 3 and 4 are detailed in Annex 1.
60. It should be noted that the FSA's own costs may increase as a result of taking on regulation of a new activity. These may be mitigated by the number of new firms across whom any additional FSA resources might be spread. The extent of these additional costs would therefore be dependent on the number and type of firms wishing to obtain permission for the new activity, and the extent of the supervisory actions that the FSA consider appropriate.
61. Firms that are newly regulated to operate pension schemes may have to employ or engage a manager to oversee ongoing compliance with the regulation. The annual cost of an employee (including salary, national insurance contributions, pension contributions and accommodation) in a medium-sized firm may be in the region of £100,000. For a large firm, which may need to employ a team of people, the cost would be correspondingly greater. Persons or firms in the market may elect to pass any additional costs onto their customers (consumers) in the form of higher charges, although larger firms may be able to absorb the additional costs without having to raise charges.

Summary

62. On balance, and subject to the associated costs not constituting a significant barrier, the Government recommends Option 3. It is prepared to consider Option 4, however, should respondents indicate the advantage of opening up the market earlier outweighs the disadvantages of a two-stage amendment to tax law and a year's delay in bringing certain activities within the scope of FSA regulation.
63. The Government would welcome comments on the cost implications of the proposals, together with any supporting evidence, and in particular from:
 - a) fund managers and others indicating whether the costs outlined above would act as a significant barrier to their entry into the pensions market
 - b) any person who might apply for permission to carry on the new regulated activity, indicating what their own internal costs might be and whether these costs might be passed on to customers
 - c) SIPP operators and investment managers indicating what savings might be made were they to obtain an appropriate permission, and the extent to which such savings would offset the associated costs.

V Small Firms Impact Test

64. Most businesses affected by these proposals will be large firms in the financial services sector. By contrast, however, a great many of the 80 or so SIPP operators are small or medium-sized firms. (For these purposes, a small firm has fewer than 50 full-time employees or equivalent, while a medium-sized firm has between 50 and 250 such employees.) Although it is also possible that some firms wishing to move into the pensions market will also be small or medium-sized, it is anticipated that most such firms will be large well-established businesses looking to expand into a new market by using packaged investments. But there is also anticipated growth in the number of small SIPP operators from within the pensions industry. Therefore, this impact assessment concentrates on the SIPP industry.
65. The following information is derived from informal consultation with the SIPP Provider Group (now the Association of Member-Directed Pension Schemes), and is based partly on feedback from 56 (about 70%) of its member firms.

66. Around 50% of SIPP operators are small firms (taking into account all their activities), and about a further 20% are medium-sized. One reason for the high proportion of smaller firms is that a number of insurance companies outsource their SIPP operations to small specialist companies. Even within the larger firms, the “in-house” operation of SIPP is generally a discrete area of activity. A majority of SIPP operators are currently unregulated.
67. SIPP operators say that it is difficult to determine with any certainty the impact of regulation and additional operating costs. But operators are concerned that they may be required to provide illustrations and other features in a uniform format, which may be suitable for collective investments but unworkable for specific investments within SIPP. If this is what transpires, it could entail significant investment in new systems without any obvious benefit to SIPP holders or operators.

VI Competition assessment

68. An intended effect of this measure is to increase competition within the personal pensions market. At present, twenty insurance companies have around 90% of the market (with the largest five having about 50%), and levels of market concentration have been increasing over recent years. It is not expected that the market will change greatly as a direct consequence of these proposals being implemented. But as a key purpose of the measure is to widen the market, the outcome is expected to be a greater and more diverse range of providers in the longer term.
69. As an effect of this measure, new firms entering the market are likely to face higher costs than those already with a market share. But because there is pressure from such firms to gain entry to the market, it is expected that many would be prepared to bear these costs, which will be offset by profits from this new area of business.

VII Enforcement, sanctions and monitoring

70. The FSA will be responsible for granting any new permission, monitoring subsequent activity, and generally ensuring that any persons who are subject to regulation are appropriately authorised. New schemes will register with HMRC via an on-line application process. As part of that process, the scheme administrator will be asked whether the person establishing the scheme is entitled to do so under the tax rules. HMRC can then check with the FSA Register that the person has the appropriate permission. If the establisher is not in possession of that permission, the scheme will cease to be registered, which means that it will not be entitled to tax privileges.
71. For tax purposes, possession of the FSA permission would be a key entry qualification. But the test would only apply as a filter at the point of registration, and continued possession of the permission would not be a tax requirement. That is because once a scheme has become registered by HMRC, it would be subject to the tax rules in FA 2004 (which, for example, prevent payments out of the scheme before the member’s retirement or death). In the event of non-compliance, HMRC would be able to impose tax charges and possibly penalties or (in the most serious cases) withdraw the scheme’s registered status so that it loses tax privileges.
72. If the proposals are implemented, it is intended that the overall outcome would be reviewed after five years. This review would consider whether the objectives at paragraph 1 had been met. In particular, the review would focus on the number of new pension providers and the range of pension products on the market. The intention would be to publish the findings.

VIII Consultation

Within Government and with regulatory bodies

73. These proposals have been discussed by officials at HM Treasury, HMRC and with the FSA. In addition, the Department for Work and Pensions and the Pensions Regulator have been notified of the proposals.

Public consultation

74. Since the autumn of 2004, there has been informal consultation about these proposals between HMRC officials and a number of bodies in the financial services industry. These bodies included the Investment Management Association, the Pep and ISA Managers' Association, the Association of Investment Trust Companies, and the SIPP Provider Group.
75. This Regulatory Impact Assessment accompanies a formal consultation document, published in September 2005. In accordance with Cabinet Office guidelines, a period of twelve weeks is being allowed for the receipt of responses.
76. Any comments on this Regulatory Impact Assessment should be sent to the contact point below, to arrive no later than Friday 23 December 2005.

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Annex 1

Examples of possible regulatory fees and levies for new regulated activity

(Based on fees and levies current for 2005/6 financial year)

Type of Firm	Authorisation Fee	Variation of permissions fee	Ongoing annual fess and FOS/FSCS levies
Existing authorised firm – fund manager within A7 fee block – applying for new permission of operating a personal pension scheme	N/A	£2,500	Medium Sized Currently c.£23,000 if managing funds of £1bn. Increases to c.£33,000 if managing £1.5bn. Small Sized Upwards of £25,000 Large Sized Upwards of £250,000
Newly authorised firm (assume within A7 fee block), whether new to pensions or currently operating pensions through a third party	£5,000 (assuming moderately complex case)	N/A	Medium Sized Currently c.£23,000 if managing funds of £1bn. Increases to c.£33,000 if managing £1.5bn. Small Sized Upwards of £25,000 Large Sized Upwards of £250,000
Holder of permission under article 52 of RAO (operating a stakeholder pension scheme)	N/A	To be decided, but could be waived	No change from existing amounts (mostly insurance companies operating personal pensions as well as stakeholder pensions)
Life insurer already operating a personal pension scheme	N/A	To be decided, but could be waived	No change from existing amounts
Exiting adviser firm	N/A	Likely to be waived	Likely to be no change from existing amounts

A

THE FINANCE ACT 2004, SECTIONS 154 AND 155 (AMENDMENT)

STATUTORY INSTRUMENTS

2006 No.

PENSION SCHEMES

The Finance Act 2004, Sections 154 and 155 (Amendment) Order 2006

Made 2006

Laid before Parliament 2006

Coming into force in accordance with article 1(2)

The Treasury, in exercise of the powers conferred on them by section 154(4) of the Finance Act 2004^(a), hereby make the following Order:

Citation, commencement and interpretation

1.-(1) This Order may be cited as the Finance Act 2004, Sections 154 and 155 (Amendment) Order 2006.

(2) This Order comes into force-

(a) for the purposes of this article, articles 2(1) and (3) and 4, on 6th April 2006;

(b) for all other purposes, on 6th April 2007.

(3) In this Order, “the Act” means the Finance Act 2004.

Amendment of section 154 of the Act

2.-(1) Section 154 of the Act (persons by whom registered pension scheme may be established) is amended as follows.

(2) For subsection (1), substitute-

“(1) An application to register a pension scheme may be made only if the pension scheme is an occupational pension scheme or has been established by a person with permission under FISMA 2000 to establish a personal pension scheme, or a stakeholder pension scheme, in the United Kingdom.”.

(3) After subsection (1), insert-

“(1A) Subsection (1) must be read with section 22 of FISMA 2000, any relevant order under that section and Schedule 2 to that Act.”.

Repeals

3.-(1) Subsection (3) of section 154 of the Act (persons by whom registered pension scheme may be established) is repealed.

(2) Section 155 of the Act (persons by whom scheme may be established: supplementary) is repealed.

(a) 2004 c. 12.

[Transitory provision

4.-(1) Until 6th April 2007, subsection (1) of section 154 of the Act is amended as follows.

(2) At the end of subsection (1), insert-

“, or

(h) any person with permission to carry on the regulated activity of managing investments or safeguarding and administering investments”.]

[Date]

Two of the Lords Commissioners of Her Majesty's Treasury

EXPLANATORY NOTE

(This note is not part of the Order)

B

THE FINANCIAL SERVICES AND MARKETS ACT 2000 (REGULATED ACTIVITIES) (AMENDMENT)

An Order made by the Treasury and laid before Parliament under paragraph 26 of Schedule 2 to the Financial Services and Markets Act 2000 (c. 8) for approval by a resolution of each House of Parliament within a period of twenty-eight days beginning with the day on which the Order is made, subject to extension for periods of dissolution, prorogation or adjournment of both Houses for more than four days.

STATUTORY INSTRUMENTS

2006 No.

FINANCIAL SERVICES AND MARKETS

The Financial Services and Markets Act 2000 (Regulated Activities)(Amendment) Order 2006

<i>Made</i>	2006
<i>Laid before Parliament</i>	2006
<i>Coming into force</i>	6 th April 2007

In the opinion of the Treasury, one of the effects of the following Order is that an activity which is not a regulated activity (within the meaning of the Financial Services and Markets Act 2000^(a)) will become a regulated activity;

The Treasury, in exercise of the powers conferred on them by sections 22(1) and (5) and 428(3) of, and paragraph 25 of Schedule 2 to, the Financial Services and Markets Act 2000, hereby make the following Order:

Citation, commencement and interpretation

1.-(1) This Order may be cited as the Financial Services and Markets Act 2000 (Regulated Activities)(Amendment) Order 2006 and comes into force on 6th April 2007.

(2) In this Order, “the principal Order” means the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001^(b).

Amendment of the principal Order

2.-(1) The principal Order is amended as follows.

(2) In paragraph (1) of article 3 (interpretation)-

(a) for the definition of “occupational pension scheme”, substitute-

““occupational pension scheme” has the meaning given by section 1 of the Pension Schemes Act 1993 but with paragraph (b) omitted;”;

(b) after the definition of “pension fund management contract” insert-

““personal pension scheme” means a scheme or arrangement which is not an

(a) 2000 c. 8.

(b) S.I. 2001/544, to which there are amendments not relevant to this instrument.

occupational pension scheme and which is comprised in one or more instruments or agreements, having or capable of having effect so as to provide benefits to or in respect of people-

- (a) on retirement,
- (b) on having reached a particular age, or
- (c) on termination of service in an employment;”.

(3) In the title of Chapter XI of Part II (stakeholder pension schemes), omit “stakeholder”.

(4) For article 52 (establishing etc a stakeholder pension scheme), substitute-

“Establishing etc a pension scheme

52. The following are specified kinds of activity-

- (a) establishing, operating or winding up a stakeholder pension scheme;
- (b) establishing, operating or winding up a personal pension scheme (not being a stakeholder pension scheme).”.

(5) For article 82 (rights under a stakeholder pension scheme), substitute-

“Rights under a pension scheme

82.-(1) Rights under a stakeholder pension scheme.

(2) Rights under a personal pension scheme.”.

Consequential amendments to secondary legislation

The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 (SI 2001/1062)

3.-(1) The Financial Services and Markets Act 2000 (Collective Investment Schemes) Order 2001 is amended as follows.

(2) In article 2, for the definitions of “occupational pension scheme” and “personal pension scheme”, substitute the following at the appropriate places-

““occupational pension scheme” has the meaning given by section 1 of the Pension Schemes Act 1993 but with paragraph (b) omitted;

“personal pension scheme” means a scheme or arrangement which is not an occupational pension scheme and which is comprised in one or more instruments or agreements, having or capable of having effect so as to provide benefits to or in respect of people-

- (a) on retirement,
- (b) on having reached a particular age, or
- (c) on termination of service in an employment;”.

The Financial Services and Markets Act 2000 (Carrying on Regulated Activities By Way of Business) Order 2001 (SI 2001/1177)

4.-(1) The Financial Services and Markets Act 2000 (Carrying on Regulated Activities By Way of Business) Order 2001 is amended as follows.

(2) In article 3(2)(h), omit “stakeholder”.

(3) In article 4(3), for the definition of “occupational pension scheme”, substitute-

““occupational pension scheme” has the meaning given by section 1 of the Pension Schemes Act 1993 but with paragraph (b) omitted;”.

The Financial Services and Markets Act 2000 (Exemption) Order 2001 (SI 2001/1201)

5. In article 5(1)(h) of the Financial Services and Markets Act 2000 (Exemption) Order 2001, omit “stakeholder”.

The Financial Services and Markets Act 2000 (Professions)(Non-Exempt Activities) Order 2001 (SI 2001/1227)

6. In article 4(e) of the Financial Services and Markets Act 2000 (Professions)(Non-Exempt Activities) Order 2001, omit “stakeholder”.

The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529)

7.-(1) Part II (controlled investments) of Schedule 1 to the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 is amended as follows.

(2) For paragraph 20 (rights under a stakeholder pension scheme), substitute-

“Rights under a pension scheme

20.-(1) Rights under a stakeholder pension scheme.

(2) Rights under a personal pension scheme.

(3) “Stakeholder pension scheme” has the meaning given by article 72(4).

(4) “Personal pension scheme” means a scheme or arrangement which is not an occupational pension scheme and which is comprised in one or more instruments or agreements, having or capable of having effect so as to provide benefits to or in respect of people-

(a) on retirement,

(b) on having reached a particular age, or

(c) on termination of service in an employment.”.

(3) In paragraph 28 (interpretation), for the definition of “occupational pension scheme”, substitute-

““occupational pension scheme” has the meaning given by section 1 of the Pension Schemes Act 1993 but with paragraph (b) omitted;”.

[Date]

Two of the Lords Commissioners of Her Majesty’s Treasury

EXPLANATORY NOTE

(This note is not part of the Order)

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