

Government response to the consultation on Sandler 'stakeholder' product specifications

July 2003



HM TREASURY

DWP Department for
Work and Pensions



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the consultation on Sandler
'stakeholder' product specifications**

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CONTENTS

Executive Summary	2-4
Introduction	5
1. About the Consultation	6
2. Aims and Objectives of Policy	7-8
3. Nature and Extent of Target Market	9-11
4. Range of Products Available	12-14
5. Investment Restrictions (Non-Pension)	15-18
6. Price Caps	19-21
7. With-Profits Proposals	22-27
8. Stakeholder Pension Issues	28-29
9. Branding and Promotion /Future of CATs	30-32
10. Next Steps	33
Annex 1: Summary of Responses to Questions	34-36
Annex 2: List of Respondents and Firms Seen	37-38

EXECUTIVE SUMMARY

Background

1. Following a recommendation of the Sandler Review, in February 2003 the Government published its proposals for a suite of simple, low cost, risk-controlled 'stakeholder' investment products, to be sold through a simplified sales process.
2. The products were aimed at driving competition in the retail financial services industry and at increasing access to the market for those on lower incomes who it is currently not sufficiently remunerative to serve.
3. The consultation invited comments on a number of issues, including: the product range, the investment restrictions, the suitability of a 1% charge cap, the simplification of with-profits products and the ways of folding the stakeholder pension into the new sales regime.
4. Over 70 formal responses to the consultation were received, predominantly from industry or industry representatives. Additionally, officials met with over 40 providers, distributors, regulators and consumer groups. The Financial Secretary to the Treasury hosted a seminar in April for senior representatives of industry, consumer groups and regulatory bodies.

Objectives

5. Nearly all respondents shared the Government's aims and objectives. But while some saw significant potential for the policy, a number expressed some caution about the extent to which a supply-side initiative alone could bring about these aims.

Government Response:

6. The Government regards this policy as part of a wider set of policies to improve the workings of the retail financial service sector. The proposals in this consultation are an important element of the success of that wider agenda.

Target Market

7. Some respondents saw mass market potential for these products. Others suggested that higher net worth investors could in practice end up being targeted. A number of respondents called for greater clarity about the nature and extent of the likely target market for the products.

Government Response

8. The Government remains committed to these products being designed to meet the needs of lower income groups. It accepts that it would be helpful for all to have

greater clarity about the potential market for these products. A demand-analysis will therefore form part of the charge cap research to be published later in the year.

Product Range

9. There was broad support for including a pensions product and a medium term savings vehicle, with the latter having a smoothed investment option. Many supported a link with the Child Trust Fund. There was a range of views about whether to include some form of guaranteed product. There was little support for any other products being included in the range.

Government Response

10. The Government proposes adding a short-term cash deposit (in the form of a rebranded CAT-mark cash-ISA) to the product range. This will provide a short-term savings option of value to consumers who may not want equity exposure. This will stand alongside a medium term product, in either unitised or smoothed form, and a pensions product, in the form of a modified stakeholder pension.

11. The Government is also committed to making the Child Trust Fund (CTF) available within the stakeholder product suite. Further details will be set out in the September 2003 CTF publication.

12. There will be no guaranteed product, in part due to the presence of a cash-ISA.

Investment restrictions

13. Many respondents agreed to a principles-based diversification approach with a 60% cap for the medium term product. A number of respondents favoured an alternative “risk-grading” approach.

Government response

14. The medium term product will have a 60% equity cap and a requirement to diversify to meet the needs of a cautious investor investing for a 5-10 year period. There will be no additional specified quantitative restrictions, though the Government does not expect firms to invest heavily in sub-investment grade or long-dated bonds.

15. The stakeholder pension will require a lifestyled default fund, so that investments are moved into less volatile assets as retirement approaches. The Department for Work and Pensions will be consulting on this later in the year.

Charge Cap

16. The great majority of respondents suggested that a 1% cap would generate insufficient returns over too long a pay back period, while making it difficult to target those at the lower end of the market. A minority believed that 1% allowed for

sufficient margins and that raising the cap would not in fact lead providers to put additional resources into targeting those on lower incomes. A number noted that whatever the price cap it must be set at a level which provides a cautious consumer with likely returns above those available on the best deposit accounts.

Government response

17. Taking account of the representations from the industry, the Government will decide on the structure and level of the charge cap by the end of the year. It will take into account, as reflected in the charge cap research it has commissioned, the impact on the consumer and the overall economics of product manufacture and distribution, on which one influence will be the FSA's proposals for regulation of the sales process.

18. The independent charge cap research will be published later in the year.

With-Profit Proposals

19. There was wide support for many of the proposals, including the 100/0 structure and explicit charges, but wide concern about others, including separate companies, disclosure of asset share and prescribed smoothing method.

Government Response:

20. A smoothed investment fund option will be available within the suite of stakeholder products. The main features of the smoothed fund will be: a fund structure of 100/0, explicit management charges (within the charge cap) and the fund will be unitised with the unit price calculated and published on a daily basis. In addition, there must be annual reporting of fund performance.

Branding and promotion

21. Views were split over the use of the 'stakeholder' brand. A number of respondents noted that provision of a wider promotion campaign was more important than the actual brand name.

Government Response

22. The product range will be called "stakeholder". Further consideration will be given to the nature of any additional Government commitment to the marketing and promotion of these products.

Next Steps

23. The Government will be consulting on detailed regulations later this year. The Government and FSA aims to have the regulations for both the sales process and the product specifications in place during the second quarter of 2004. The stakeholder suite will be available on the market from April 2005.

Introduction

1. This paper contains the Government's response to the consultation on the product specifications of Sandler "stakeholder" products¹, which ran from 5th February to the 2nd May 2003. It also contains consultation feedback.
2. It is structured as follows:
 - **Section 1** provides background about the consultation process
 - **Sections 2-9** discusses the main policy issues, breaking down each into a summary of the Government's original proposals, a summary of the consultation findings, and details of the Government's formal response
 - **Section 10** explains the next steps
 - **Annex 1** provides a summary of responses to the 30 specific questions asked in the consultation. **Annex 2** provides a list of respondents and firms seen.
3. Two additional issues should be noted upfront.
4. First, the Financial Services Authority (FSA) have separately undertaken an initial consultation on options for regulations for the sales process in their Discussion Paper 19. Their feedback statement is being published to coincide with this document and should be read alongside it. The Government is aware of the importance of having a sales process for stakeholder products that reflects the product safeguards and is robust in limiting consumer detriment, and will continue to work closely with the FSA.
5. Second, in the light of the FSA's commitment to begin market testing a "filter questions" approach to the sales process, and following representations from industry that the charge cap for these products should only be set once there is greater clarity about the nature of the filter questions and the length (and therefore the cost) of the sales process, the Government has decided to postpone its final decision on the structure and level of the price cap until the results of this market research are known later this year.

¹ This is available on-line at: http://www.hm-treasury.gov.uk/consultations_and_legislation/consult_sandler_products/consult_sandlers_index.cfm

1. About the Consultation

6. The consultation proposals took forward one of the main recommendations of the Sandler Review of Medium and Long Term Savings in the UK, which called for the creation of a new suite of simple, investment-restricted, low cost, investment products to be sold via a simplified sales process.
7. The Government consulted widely on its proposals. In addition to the formal consultation, meetings were held with over 40 fund management and life insurance firms, banks and building societies, consumer groups and others to discuss the issues raised. The Financial Secretary also held a seminar for key stakeholders and officials spoke at a number of conferences.
8. The list of those who responded formally to the consultation is set out in Annex 2. Those who would like to receive copies of the non-confidential responses should contact Kevin Dignan at kevin.dignan@hm-treasury.gov.uk, making clear which of the responses they would like to receive.
9. The majority of respondents to the consultation came from providers and distributors. In determining the appropriate way forward, the Government has sought to balance these views with those of the other major stakeholders, including those of consumer representatives.
10. The Government received a large number of detailed and carefully considered responses to its consultation, and is extremely grateful to all who have spent time and effort in developing their response to this policy initiative.

2. Aims and Objectives of Policy

Consultation Proposals

11. The consultation set out the rationale for the development of a new set of products, based on the recommendations of the Sandler Review. The policy is part of the wider Government agenda of driving competition in the retail financial service industry and increasing access to financial services for those on lower incomes who were currently deterred from saving by:
 - complexity and opacity in the market;
 - a relatively elaborate sales process, designed to cope with complex products, that tends to disenfranchise some consumers who become uneconomic for the financial services industry to reach.

Consultation Responses

11. There was widespread support for the aim of increasing the savings levels of the UK. Views were split as to what extent the Government's proposals would help tackle under-saving. While some expressed optimism, most regarded the policy as a potentially helpful step in the right direction, rather than as an initiative that would transform the market quickly. It was widely felt that, to increase savings, demand-side measures such as increasing education and financial awareness would be as necessary as supply-side measures such as this.
12. There was also widespread support for increasing access to the market for those on lower incomes. But many suggested that further segmentation of the market was necessary to account for the fact that those on lower incomes are often in debt, and, if not in debt, are unlikely to have spare cash to invest beyond a deposit account. A number of concerns were also raised about the desirability of pushing those who were least able to afford capital losses into equity-based products. Others noted that some higher net worth consumers could also be attracted to the market.
13. There was a range of views about the extent to which competition in the industry needed to be enhanced. Some in industry argued that the market was already a competitive one, and that Government attempts to stimulate competition through price caps were unnecessary. Others, particularly among consumer groups, stressed that the industry still had a long way to go before it was a demand-led industry competing efficiently on price.

The Government's Response

14. The Government remains committed to its original objectives of countering the market failure identified in the Sandler report to help ensure that the needs of those on lower incomes are better served. It welcomes the broad support for these aims. The evidence that those on lower incomes are being excluded from

the market by the complexity of the market and the nature of the regulatory system- both issues that this policy is addressing- remains compelling. This is not to suggest that all on lower incomes should consider purchasing stakeholder products.

15. The Government views this policy as part of its wider savings strategy. Integral to this are the measures set out in the Government's response to the Pensions Green Paper, the pensions tax simplification consultation document and the forthcoming document on the Child Trust Fund, in addition to the role played by the FSA and others to promote financial awareness and education. The Government will continue to drive this agenda forward, as demand-side measures in a market with asymmetric information are clearly of value. But supply-side reform as represented by the Sandler recommendation for simplified, lower risk products capable of being sold under streamlined regulatory requirements is a very relevant complement.

3. Nature and Extent of Target Market

Consultation Proposals

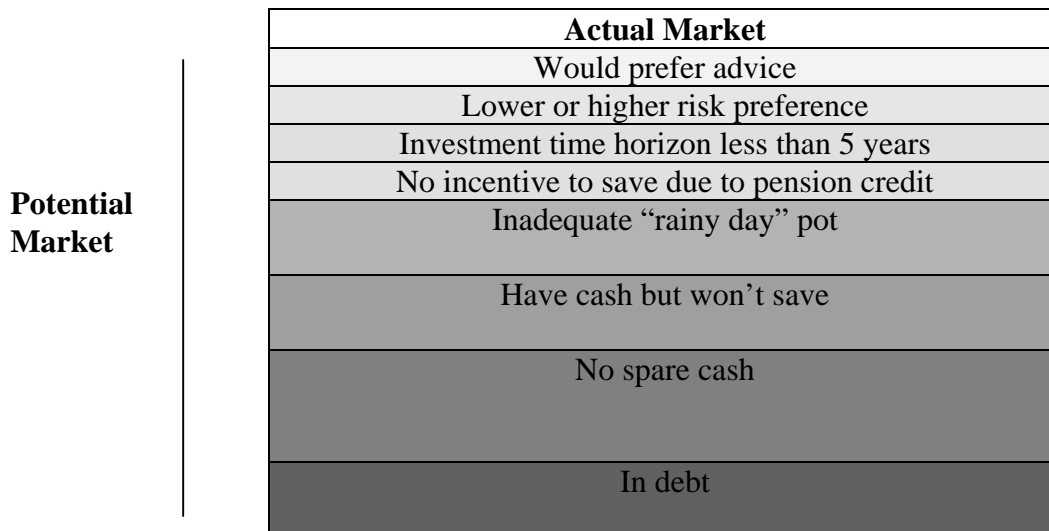
16. The Government proposed that the target market comprise those in low to medium income groups who are currently priced out of the market for retail savings advice, though it recognised that the products would be of value to all those seeking simple, investment-restricted, low-cost investments. This market could be defined in terms of household earnings, household savings levels, the 3m who are seriously under-saving for their retirement with the further 5-10 m who may also be under-saving, and the 15m “novice” investors.

Consultation Responses

17. A number of respondents called for greater clarity about the nature and extent of the target market. The ABI noted that depending on how it was defined, the Government’s categories stretched from just 1m to around 24m potential customers. It was variously suggested that greater clarity would help:
 - Facilitate effective product design
 - Enable the measurement of success
 - Reduce the possibility of mis-selling
 - Enable the design of an appropriate charge cap.
18. A number of respondents also made the distinction between the *potential* market for the product and the *likely* market for the product (see Figure 1). The size of the latter is what matters most to firms and Government, and depends on:
 - The right product- the extent to which it meets consumer needs
 - The appropriate pricing- via the impact of charge caps
 - An effective sales regime- which is an effective safeguard against mis-selling or mis-buying and allows for products to be “sold”
 - High quality promotion by both industry and Government
 - Other factors such as the course of the stock market.
19. Given this distinction, there was a degree of scepticism about whether the actual market would meet the Government’s declared aims of targeting the products towards those on lower incomes. There were suggestions that potential problems included the wrong product (with equity based products not being suitable for many) offered at a price that may not enable sufficient

returns on capital, sold via too onerous a sales process (with many being filtered out by the filter questions) while also being poorly promoted. The interaction with the benefit system also needs consideration. Figure 1 shows the potential impact of some of these factors.

Figure 1: Potential vs Actual Market (not to scale)

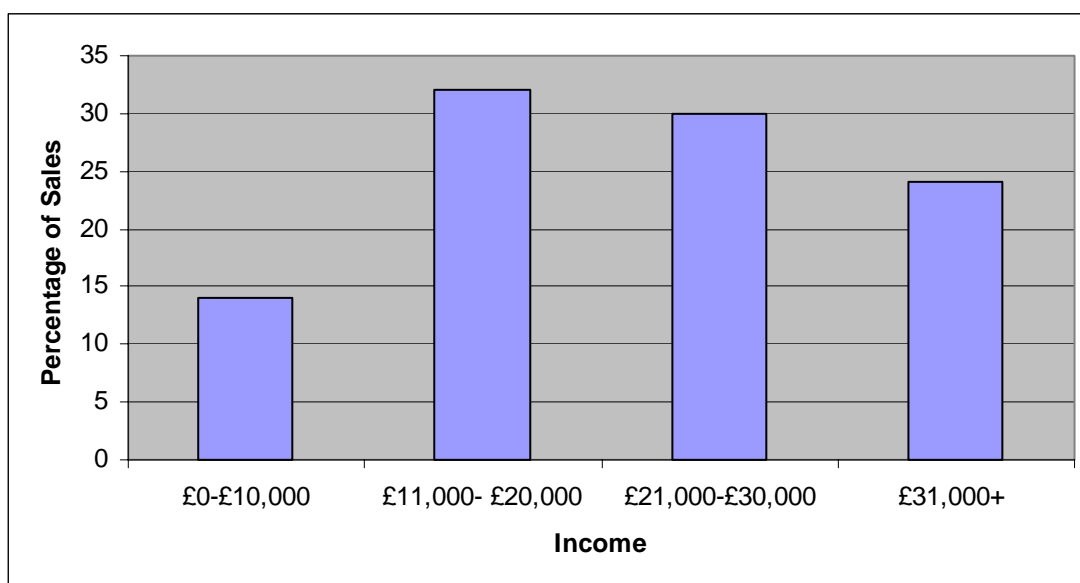


20. A number of respondents were more optimistic about the potential size of the target market. Several major players believed there was mass-market potential for the products, and that they could make a significant impact on the retail financial services industry as a result. A number also saw the potential for these products also to be of value to higher net worth but relatively risk-averse investors. Some suggested that the stakeholder pension experience indicated the possibility of up-market drift.

The Government Response

21. The Government will set the product specifications so as to appeal to those on lower incomes. The Government sees stakeholder products as only part of the market for retail financial services, but the products may also be of value to cautious investors on higher incomes and for those who want to “switch” to a low cost investment product to get better value for money. As such, if sales are also made to higher income groups, the Government would not consider this a problem.
22. The Government observes that the experience of stakeholder pensions in this regard is better than many commentators assume. Recent research for the FSA has indicated that a large proportion of sales of stakeholder pensions are to those on lower incomes (Figure 2). The Government expects that the wider product range will similarly prove attractive to those on lower incomes.

Figure 2: Stakeholder Pensions Policyholders, by Income bracket



Source: KPMG research for FSA

23. The Government recognises that greater clarity about the nature and extent of this market would be helpful. FSA decisions on regulation of the sales process will now be facilitated by the firming-up of the product suite set out in this paper. Until the further FSA work is complete it is difficult to estimate the likely market size precisely. But sensitivities to various relevant parameters can be illustrated, as can the current savings habits of those on lower incomes. A demand analysis will therefore form part of the wider Deloitte and Touche research that the Government has commissioned into charge caps.

Key Proposals

- **The Government remains committed to these products being designed to meet the needs of those on low to medium incomes.**
- **It recognises that they will not be appropriate for all in these categories. Nor will these be the only buyers.**
- **A detailed independent study of the nature and extent of the likely buyers of these products will be included in the research into charge caps to be published later in the year.**

4. Range of Products Available

Consultation Proposals

24. The Government proposed three products in the range: a unitised product, a with-profits product, and a pensions product. It suggested the unitised product could be available in either collective investment scheme or life form. It also consulted on whether there should be other products in the range, providing the case for and against adding a guaranteed product, term assurance, deposits, annuities, a financial health check and the Child Trust Fund.

Consultation Responses

25. There was wide support for including the three main products identified, with a number of important accompanying comments:

- Many suggested that the consultation confused product wrappers with investment choices. Of the three main “products” it was suggested that from the consumer need angle there were only two: a *medium-term* investment vehicle, which could have either a smoothed or unsmoothed investment choice and a *long-term* pensions investment vehicle.
- There was near unanimous support for folding the current stakeholder pension into the new product range, as it was thought to be a recipe for confusion to have two ranges of such pension products running in parallel.
- Most agreed a with-profits option would be worthwhile, though a small number of respondents suggested that the with-profits option was inherently too complex to be included as an investment choice in “simple” products aimed at relatively unsophisticated investors.
- There was broad support for including both collective investment schemes and life schemes, subject to each being able to operate under the same ISA treatment (i.e. allowing a £7,000 maximum contribution per annum to an insurance ISA, up from the current £1,000). More generally, favourable tax treatment was thought to be vital to the products’ success.

26. In terms of potential extensions to the product range, there was near universal rejection of annuities and term assurance. A financial health-check was thought to be of potential value, but as it was not an investment product it was not felt to fit comfortably with the product range. There was general support for rebranding the CAT-mark cash-ISA, in part so as to provide an option for those not looking for equity exposure. Many also favoured a link between the product range and the Child Trust Fund (CTF), though there was little consensus about how this might best be achieved, in part due to the lack of certainty around the product specification for the CTF at the time.

27. There were widely contrasting views as to whether there should be a guaranteed investment option available in the suite. Those in favour noted that it would be a natural first step for those new to equities and that it would appeal to cautious investors. Those against agreed with the assessment in the consultation paper that the products could in practice represent indifferent value for money, could be inflexible and complex, and that would often have the guarantee constrained in some way.

Government Response

28. The Government welcomes the support for including a medium term investment vehicle and a pension within the range, and accepts the arguments for adding a vehicle for short-term savings to meet the demand for those in the target market who may not want equity exposure in the form of a rebranded CAT-standard cash ISA. This will also allow all Government-standard investment products to come under one brand. The implications of this for the wider CAT-standard range are explored in Section 9 below.
29. The Government is also committed to making the Child Trust Fund (CTF) available within the stakeholder product suite. Further details will be set out in the September 2003 CTF publication.
30. The medium-term investment vehicle will be available in either collective investment scheme or life form. Smoothed investments will be permissible given their value in lowering volatility. The Government accepts that smoothed investments are more complex than simple unitised products, but believes that the proposals set out in Section 7 will mitigate these problems.
31. In order to ensure that the medium term product has the flexibility many consumers would expect, the products must be open-ended, with no lock-ins or early redemption charges. They should be valued daily. To ensure providers do not insist on high minimum contributions, the Government will consider the need for a minimum contribution level.
32. The Government understands the arguments for the medium-term product being made ISA-able in both its life and collective investment form. It is considering options for giving all the stakeholder medium-term investment options (unit trust, unit linked and smoothed investment fund) equal treatment in the ISA regime. This could have implications for the current insurance ISA. Inland Revenue officials will contact ISA manager representative bodies to arrange meetings in early autumn to discuss this. Earlier views would of course be welcome.²
33. The Government does not believe it is desirable to have two Government-regulated pension products. The pension product will be a modified stakeholder pension. Details of this are set out in Section 8.

² Comments in writing should be sent to David Ensor - Room 135, New Wing, Somerset House, Strand, London, WC2R 1LB).

34. In the light of the consultation responses suggesting that the product range is best kept relatively simple, and in recognition of the inherent arguments against including a number of the options floated in the consultation paper, the Government does not propose to include term assurance, annuities or a financial health check in the product range.
35. Despite it not being offered in the stakeholder range, the Government is committed to developing opportunities for more generic advice. Of particular relevance here is the FSA's work in producing its interactive Financial Healthcheck tool.
36. There will be no separate guaranteed investment product in the stakeholder range. The Government understands there is some market demand for such a product, but guaranteed products operating with lump sum investments over fixed time frames do not fit well with the desired flexibility of the product range. The addition of the cash-ISA to the range further weakens the case for including a guaranteed product.

Key points

- **There will be three stakeholder products, with a cash product sitting alongside the medium-term investment and the stakeholder pension.**
- **The medium term product will be available in either collective investment scheme or life form. Smoothed investments will be permitted.**
- **The Government is also committed to making the Child Trust Fund (CTF) available within the stakeholder product suite. Further details will be set out in the September 2003 CTF publication.**

5. Proposed Investment Restrictions (Non-Pension)

37. This section addresses the investment restrictions for the medium term collective investment scheme/life product. The restrictions for the stakeholder pension are set out in Section 8.

Consultation Proposals

38. For the medium term investment vehicle, the principal proposal was for a 60% cap on equities, to ensure that consumers were not exposed to the full price volatility of the stock market. It also specified that there would be further diversification requirements, either in the form of general principles or as quantitative limits. Views were also sought as to:

- whether the fixed interest component should be limited in some way
- whether there should be a minimum equity exposure
- whether the Government was right to reject quantitative volatility measures such as tracking errors
- whether the with-profits fund required different risk controls to the non-smoothed unitised fund.

Consultation Responses

39. There was a wide range of responses to these proposals.

40. The diversification approach to ensuring the products are not high risk was generally accepted, and many were content with a 60% maximum equity exposure. But a number of respondents felt that 60% was too high for a target market in which many might have little or no previous experience of the stock market and who could well have no wider portfolio of financial assets. Others felt that the 60% cap was too low, given that a 100% equity tracker fund could form an appropriate part of a diversified portfolio, especially when balanced with money in a deposit account. These responses also observed that for some people the “shortfall risk” (of not making sufficient investment gains) would be higher than the “downside risk” (of losing some of the original capital investment), and that for these investors an equity cap could *raise* risk.

41. In terms of additional restrictions to the products, most favoured a principles-based approach, though a small number of major players favoured extra quantitative requirements. The key arguments are set out in Figure 3.

42. A number of respondents did, however, make suggestions for potential extra rules. The IMA suggested a requirement that funds be invested at least 50% in sterling/euro. Others suggested limits to sub-investment grade and long-dated

bonds. The ABI suggested that if extra rules were required they could potentially be linked to weightings relative to all recognized worldwide exchanges. Few favoured a minimum ‘floor’ to the equity exposure. Nearly all agreed that whatever the rules, for simplicity the smoothed fund should have the same risk controls as the non-smoothed fund.

Figure 3: Arguments for and against using general principles rather than quantitative rules in terms of investment restrictions

For	Against
<ol style="list-style-type: none"> 1. Rules add to cost for providers and complexity for consumers 2. Rules are unable to move with changing market conditions 3. Rules give a spurious degree of confidence in the products 4. Principles work to help enhance product innovation 5. Rules provide a high level of reputational risk for the Government 	<ol style="list-style-type: none"> 1. Rules provide greater clarity for firms 2. Rules may provide greater clarity for the consumer

43. A number of respondents favoured an alternative risk management approach not suggested in the Government’s proposals: namely some form of risk-grading/risk disclosure. These respondents noted that given a likely wide range of investment goals, time horizons and risk attitudes within the target market, it was inappropriate for the Government to be effectively ruling out some categories of funds via a specified equity limit. A variety of “bands” were therefore proposed, providing low, medium and high-risk options for consumers to choose between, with the high-risk band having an equity cap above 60%. This, it was suggested, would in principle enable a better matching of the risk profile to the product, educate the consumer in risk-return and help reduce any potential “guarantee” implication from the brand.

The Government’s Response

44. The Government is encouraged by the breadth of support for the proposed 60% cap on equities for the unitised product, and proposes to require it for the medium term vehicle. A 60% equity exposure offers the probability over the medium term of higher returns than deposits- assuming a 7% return for equities and 4.5% for bonds this would imply an expected return of 6% with 60:40 equity-bond ratio. But it should not result in high price volatility of the kind that is unlikely to be attractive to those who are unable to balance this risk with substantial cash holdings- the higher “balanced managed” equity level of 85% would, for example, have led the average life fund investor to lose 18% of their fund over the past 5 years.

45. The Government recognizes that controls over equity exposure do not remove all risk of loss- this is in the nature of the risk-return trade-off. But it believes that its proposals balance risk and return in a sensible way.
46. Such a restriction also benefits from being both simple to understand and relatively easy to enforce. It will help provide firms with some form of signpost of acceptable fund design, while enabling sufficient breadth of design to enable a range of consumer preferences to be catered for. A 60% cap is precisely that- a cap which limits equity exposure while allowing firms to develop products with a lower exposure should they feel it appropriate.
47. Given that conventional treatment within the life field is that property and equity are bracketed together in this regard, the Government proposes that the 60% limit apply to property and equities combined.
48. The issue of the time-frame over which firms will be expected to adjust to rising markets to ensure that their funds do not over-expose investors to equity risk is an important one. The Government proposes that a reasonable time frame be allowed for this to take place. It will discuss the issue with industry representatives with a view to making firm proposals when it publishes draft regulations later in the year.
49. In order to make it unlikely that over much shorter time periods investors experience significant capital loss, the Government also proposes to introduce some form of additional high-level diversification requirements (the “principles-based” approach to limiting risk). An over-riding principle making clear that firms should design these products for the cautious investor investing over the medium term will also be required. This will provide a catchall net to stop firms developing high-risk strategies. A specified minimum equity level will not be required but diversification across asset classes will mean in practice that all funds should have some equity exposure. The Government therefore proposes the following form of words:
- “Investments designed to enable a relatively cautious investor aiming to invest for 5-10 years to benefit from some of the growth potential of the stock market without being exposed to the price fluctuation of higher risk investments. They must be well diversified across a range of different asset classes, markets, sectors and securities. Equity and property exposure must not exceed 60% combined.”*
50. There will therefore be no additional quantitative limits on the fund. In particular, there will be no specific limits on the fixed interest section of the fund, though given the requirement that funds be designed for the cautious investor, firms would be expected not to expose investors to a high proportion of high-risk bonds, be they long-dated or sub-investment grade. Equally, this requirement would preclude firms investing heavily in high-risk equities. Similarly, derivatives should only be used for the purposes of efficient portfolio management (EPM).

51. The Government understands the arguments for the alternative “risk-grading” approach for the medium term product. But the disadvantages are also clear. There is the risk of cautious, inexperienced investors mistakenly choosing a fund that has higher volatility than they can really accept. And there is also a real issue of whether any extended choice between funds will be possible within a simplified sales process, especially given the lack of financial sophistication of the target market.
52. The Government appreciates that a product with a potential 60% equity exposure is not one that should be regarded by consumers as “safe” or even “low risk”, especially given that some consumers will inevitably end up investing for less than a recommended minimum of 5 years. It also appreciates that the potential for consumers to view these products as in some way guaranteed by Government must be minimized. The need to get effective means in place by way of product warnings and risk filters will be an important issue for the FSA in its work on the sales process. FSA proposals to review projection rates on investment products, as announced on 23rd June, should also help in this regard.

Key points

- **The unitised fund will have a 60% equity limit and a requirement to diversify across a range of asset classes, markets, sectors and securities to meet the needs of a relatively cautious investor investing for 5-10 years.**
- **Smoothed funds will have the same restrictions as unsmoothed funds**

6. Price Caps

Consultation Proposals

53. The consultation set out reasons why, given a lack of price competition and consumer weakness, a price cap is a desirable component of the new product range intended to tackle market failures excluding those with less to invest. It noted that 1% in stakeholder pensions and the CAT-marked ISAs had brought considerable efficiencies in the industry while providing a good value, readily communicable proposition to consumers.
54. For these reasons, the Government has a high threshold for persuasion for moving from a flat 1% charge. But in recognition of industry concerns about inadequate returns to capital and long pay-back periods, and in the light of the Government's commitment that the products should be sold to those on lower incomes, representations on the subject were sought, and independent research has been commissioned. Views were also sought on appropriate charges for smoothing, and on whether the pensions product had significantly differing economics to the unitised product.

Consultation Findings

55. The charging aspect of the proposals generated a greater volume of respondent comment than any other. Most suggested that getting the level of the charge cap right was the single most critical issue to the policy's success.
56. There were a number of comments about the principle of price caps. Certain organisations reiterated their belief that charge caps were wrong in principle, arguing that the market was competitive and charges would therefore be distorting in their effect. Others suggested that though there may be market failures other public policy responses existed. Benchmarking, for example, could result in the disclosure of prices within certain bands instead of an overall cap being imposed.
57. On the actual level of any price cap, the great majority of respondents believed that a 1% AMC would be insufficient, though it was recognised that without greater clarity about the potential size of the market and the nature of the sales process it was difficult to provide robust modelling estimates. A minority of respondents believed that 1% would be adequate in providing efficient providers with sufficient returns over a reasonable pay-back period.
58. Of all the arguments put forward, it was most commonly asserted that 1% would:
 - *Produce inadequate returns.* Many firms suggested that they were currently looking to get a return on capital of around 10-12%, and that a 1% charge would not provide this. A £50 per month contract would, it was

observed, provide only £6 in the first year, against up front costs to the firm of several hundred pounds.

- *Have excessive pay-back periods.* Most firms described in detail how lengthy the pay-back periods on their investment would be, through profit signatures.
- *Fail to capture the target market.* Many observed that, though adequate returns and reasonable pay-back periods could be achieved for higher contribution levels (e.g. £150 per month), this would not be possible for the target market

59. The principal argument in favour of a 1% charge was the need to ensure that it remained in the interest of consumers to invest in equity-based products rather than take out a deposit account. Given the risk-averse nature of many in the target market this would mean that the expected returns minus charges would have to be comfortably above what could be anticipated from a deposit account. This, it was suggested, would have particular implications for a product with a 60% equity cap, as this would have lower expected returns than a 100% equity product. It was also suggested that raising the price cap would not in practice lead firms to divert resources to lower income groups, would represent a significant and unnecessary increase in funding costs for consumers and would perpetuate inefficiencies in the retail pensions and investment market.

The Government's Response

60. The Government remains committed to the principle of price caps. The evidence of lack of price competition in the market is clear, and consumers need to be confident that they are not being encouraged to buy a product that has unreasonable levels of charges. Alternatives to charge caps, such as benchmarks, have a number of attractions, but will not as of themselves enable consumers to be confident that they are buying a good value product.
61. The 1% price cap has increased price transparency and promoted competition in the market. In considering whether to change the cap, the Government will need to balance the concerns expressed by providers against views put forward by consumer groups and others of the possible effect of any change on the value of people's savings (at different stages of maturity) and the consequences of any easing effect on competitive pressures. The Government has already stated that there is a high threshold for persuasion for any move from 1%. The decision will be based on a thorough analysis of all the evidence available.
62. In order to assess the claims made by firms about a 1% AMC, on 20th March 2003 the Government therefore appointed Deloitte and Touche to conduct independent research. The research had the following terms of reference:

“The research will consider the implications of a price cap for consumers, who seek simple, good value products, and providers, who seek returns to capital, against the background of the Government’s interest in the products being marketed and distributed to those on low to medium incomes. In order to address this issue, the research should answer the following questions:

- *For the three proposed product types in the ‘stakeholder’ suite, what are the consequences for firms and for market penetration of a 1% annual charge?*
- *What alternative simple, good value models for charge caps would enable efficient firms to market/distribute these products to consumers on low to medium incomes?*
- *What consequences would flow from the range of charge caps under analysis? In particular, how would take-up of the products differ under different charges and what would be the impact on competition in the industry?*

“The research should include the arguments for and against setting different charges for each of the three proposed ‘stakeholder’ products. This should include an analysis of charging options for the smoothing element of the with-profits product. There should also be some analysis of potential charging models for a “guaranteed” product.”

63. As the consultation findings make clear, the economics of the price structure are dependent on the cost and nature of the sales regime being designed by the FSA. With the FSA currently undertaking market research into the sales process, the Government accepts the arguments that it would be untimely to set the price cap in advance of the findings of this research.
64. The Government therefore proposes setting the price cap later this year, once there is greater clarity about the nature and length of the sales process. The Deloitte and Touche research into charge caps for retail investment products will also be published later in the year.
65. Given the simplicity desired of these products, the Government proposes that all unitised products in the range must have single pricing- i.e. bid-offer spreads will not be permitted. Funds must also be priced daily.
66. Given the Government’s intention to bring the CAT standard cash-ISA into the product range, the issue of whether any changes need to be made to the current permissible charges of this product is something the Government will also be considering.

Key proposals

- **The Government will finalise the price cap later in the year, once the next stage of the FSA’s work on the new sales process has been completed.**
- **The independent research into price caps will be published later this year.**

7. With-Profits Proposals

Consultation Proposals

67. The consultation proposed that the stakeholder suite should include a with-profits option, based on the Sandler “ideal” model. The potential clarity of this model was recognised in the consultation.
68. The Sandler review proposed a radical reform of with-profits in order to ensure that they meet new high standards of simplicity and transparency. The four main features of the proposals were:
- a fund structure of 100/0³;
 - explicit management charging;
 - a separate smoothing account, balanced to be neutral in the long run; and
 - full consumer disclosure, with the ability to impose a market value adjuster (MVA) to prevent arbitrage.
69. The consultation sought views on a range of issues including: the structure of the fund; proposals for explicit charging and the operation of smoothing (including the operation of a separate smoothing account).

Consultation Responses

70. Many respondents welcomed the proposal to offer a with-profits option in the stakeholder suite of products. It was seen as being attractive to those consumers who want to invest for the future but are concerned about full exposure to investment risk. However, a number of respondents commented that it should be viewed as an investment option, an alternative to unit-linked investment, as opposed to being a separate product.
71. The proposal to require a fund structure of 100/0 for the stakeholder product was supported widely. This structure was seen as being clearer and fairer to consumers. Others commented that this structure clearly offers the benefits which should be available from a Sandler product, that is, transparent, clear charging, including clear charges for other benefits such as guarantees and clear disclosure of the assets underlying the fund. Others commented that 90/10 would effectively avoid any charge cap.
72. There were others who took the opposing view. For example, some argued that the financial strength of the provider is a more important consideration than shareholder participation in the profits of the fund. They argued that 90/10 funds lead to strong alignment between shareholders and policyholders. It is in the interests of shareholders to optimise investment performance and to

³ One hundred per cent of investment returns are distributed to policyholders and shareholder returns are instead funded by way of an explicit charge to the fund.

minimise costs. Those who supported the 90/10 structure argued that transparency could still be achieved with 90/10 funds.

73. There was widespread support for the imposition of an explicit management charge which was seen as essential to allow consumers to compare products. Some respondents commented that such a charge is essential to ensure a level-playing field with unit-linked products. On the other hand, there was significant opposition to the idea that a separate management company be established to provide the management of the fund. Respondents argued this would create additional costs and administrative burdens and would not be a simple proposition for consumers to understand.
74. There were mixed views expressed on the proposal for a separate smoothing account. A number of respondents who supported the proposal suggested this account could be maintained within the policyholders' funds, therefore avoiding any conflict of interest between policyholders and shareholders. On the other hand, the proposal was opposed by some who saw it as a potentially unnecessary cost and not particularly helpful in improving transparency to customers.
75. There was however little support for the idea of specifying either a formula or parameters for smoothing. This approach was seen as over-prescription which was unlikely to be the best approach for all consumers and could operate to the detriment of consumers in unexpected market conditions. It was also argued it would inhibit product design and remove flexibility. Some respondents were more supportive of the proposal and argued for some degree of standardisation, but with some flexibility to set the parameters.
76. Views on guarantees were also mixed. Some respondents expressed the view that future with-profits funds are unlikely to offer guarantees (which are costly to operate). Others noted the only form of guarantee to be offered with no lock-in is a deposit account. A number of respondents noted the potential value of guarantees to the target market but raised concerns about (1) whether consumers would be willing to pay for the guarantees; (2) whether guarantees are viable within a charge capped environment. Many felt guarantees would not be viable, but in general this was not felt to be a problem.
77. There continues to be widespread support within the industry for the ability to apply market value adjustments (MVAs), but widespread opposition was expressed in relation to the proposal to set the redemption value of a policy on an annual basis. Respondents commented that the proposal would act to the detriment of policyholders and setting an annual redemption value would not take account of premiums paid during the year and investment growth.
78. Some respondents broadly supported the proposed conditions under which MVAs could be applied but noted that some degree of discretion needs to be retained. Others were opposed strongly to limiting the circumstances in which MVAs could be applied on the basis this would reduce the protection offered to continuing policyholders. Concerns were also expressed about any requirement to inform policyholders in writing, in advance, of any change to

the MVA being applied. A number of respondents argued that such a requirement could lead to selection against the fund.

79. On the issue of disclosure, almost all who commented expressed concern about the proposal to require disclosure of unsmoothed asset share. Respondents felt this would lead to selection against the fund, to the detriment of remaining policyholders. A number of alternative solutions were suggested including a requirement to disclose the actual investment return achieved on the underlying assets of the fund each year – this would be easier for consumers to understand and less likely to lead to selection against the fund.
80. On the question of risk control, most respondents argued that, for the sake of simplicity and consistency, the same risk controls should be imposed across the different investment options. For example, it was argued that smoothing of with-profits payouts cannot protect against longer-term falls in the value of investments. Over the longer term, the underlying asset mix will be the core driver in terms of the returns that the policyholders receive. Others saw the case for such consistency but highlighted the potential need for some additional flexibility for with-profits funds.
81. Finally, there was widespread support for a move away from the term “with-profits”. Some respondents argued that providers would develop their own terminology. The most popular suggestions were smoothed investment fund and smoothed managed fund.

Government Response

82. The Government is proposing that a smoothed investment fund option should be available within the Sandler suite of stakeholder products. This option will provide an entry-level product for consumers who want to invest in equities but who want to be shielded in some way from the extreme peaks and troughs which can be associated with equity markets.
83. A Sandler smoothed investment fund will have a 100/0 structure. This means that all the investment returns go to policyholders.
84. Policyholders will pay an explicit management charge (subject to a charge cap) to the provider.
85. Investment returns will be smoothed by the provider – in times of high returns, a proportion of the investment return may be held back in order to reduce losses (or provide a positive return) at times of lower investment returns or losses.
86. Smoothing will be a continuous process. The fund will be unitised with smoothed unit prices published on a daily basis, helping consumers to work out what their policy is worth at a given time.

87. Smoothing will be funded from a separate smoothing account held within the policyholders' fund. Providers must aim to keep the balance of the smoothing account neutral in the long run, so a significant balance should not build up.
88. In certain circumstances the provider will be required to provide supporting capital to fund smoothing because of a deficit in the smoothing account. When this happens a charge for smoothing will be allowed. The provider will be required to account clearly for the movement of and payment for any supporting capital required to support the smoothing account. In addition, the provider will be required to notify policyholders if a charge is to be applied.
89. The provider will be required to disclose their approach to smoothing. This will need to cover how they propose to smooth returns, over what period they aim to maintain a neutral balance in the smoothing account and how they propose to deal with a surplus or deficit in the smoothing account.
90. Two ways which have been suggested to the Government as methods of operating smoothing formulas are set out in Table 2.

Table 2: Examples of smoothing formulas

<ul style="list-style-type: none"> • Smoothing performance to 50% of the difference between an expected growth rate (set by the provider) and the underlying fund performance. • Smooth investment returns over 3 years

91. The Government recognises that, in the long term, the application of such a formula is likely to result in either a surplus or deficit in the smoothing account. In order to facilitate the maintenance of a neutral balance in the smoothing account, providers will be required to review regularly their approach to smoothing. Any changes must be forewarned to investors.
92. The requirement for the fund to be unitised, and the unit price to be published daily, will remove much of the need for MVAs to be applied. Daily smoothing will enable providers to take account of the majority of the factors affecting the fund. But we recognise that providers need to retain the flexibility to deal with exceptional situations such as sudden dramatic falls in the stock market. Providers will be able to make large and sudden changes to their smoothing approach – both up and down (in limited circumstances). Changes to the smoothing approach in order to reduce policy values will be limited to those circumstances recommended by Sandler in relation to MVAs. That is, only where it is clearly related to:
- market conditions; and/or
 - entries/exits to and from the fund.

93. Case by case changes to smoothing will not be permitted. The Government will work with the FSA to ensure that “case by case” is adequately defined.
94. Providers will be required to announce publicly when they propose to make changes to their smoothing approach. This need not be through individual communication with policyholders but must be through an appropriate method, for example, an advertisement in a national newspaper.
95. The only guarantee which may be offered within a Sandler smoothed investment fund is a mortality guarantee, that is an amount payable on the death of the policyholder. The guarantee will be limited to a payout of 101% of the unit value. The charge for this guarantee must be met within the overall charge cap but should be separately identified to ensure transparency.
96. There will be increased disclosure requirements on providers. They will be required to send an annual statement to policyholders which includes the following information:
- the current redemption value of the policy – it should be made clear that this is a snapshot at a point in time; and
 - the proceeds on death, to reflect the value of protection included in the policy.
97. In addition, following the surrender of a policy, providers will be required to disclose the unsmoothed asset share as compared with the smoothed asset share. This will enable consumers to see, at a glance, the benefit of smoothing to them. The Government does not, however, propose that on an ongoing basis, this information should be available for individual policies, to prevent selection against the fund.
98. Providers will also be required to produce an annual report on the financial condition of the fund. This report should include:
- asset allocation of the fund;
 - the value of these assets;
 - the performance over the previous year of these assets;
 - costs charged to the fund.
99. The smoothed investment fund will be subject to the same risk restrictions as the unit-linked investment option. Further restrictions will apply in that investment by the fund in a company owned by the provider will not be permitted.

Key Proposals

- **a smoothed investment fund option will be available within the Sandler suite of stakeholder products;**
- **a smoothed investment fund should:**
 - **have a fund structure of 100/0;**
 - **be unitised with the unit price published on a daily basis;**
 - **have a separate smoothing account within the fund;**
 - **have explicit charges; and**
 - **provide additional disclosure to consumers.**

8. Stakeholder Pension

Consultation Proposals

100. Alternative proposals were made in the consultation. The first was to require stakeholder pensions to offer a single “Sandler” investment restricted fund, the second to bring stakeholder pensions within the Sandler “stakeholder” product regime using the already existing default⁴ investment option.
101. The consultation also asked for views on investment options in the default fund, and floated the following suggestions:
- Requiring it to be invested in a Sandler unitised/with-profits products; or
 - Requiring use of lifestyling; or
 - Requiring a general duty of care.

Consultation Responses

102. There was very strong support from respondents to the consultation for a single stakeholder pension regime. Most concerns centred on the possible implications of a change to the current 1% charge cap.
103. The majority of respondents rejected the first investment option as inappropriate because of the longer time horizon of pensions- a 60% equity cap would be too low for funds that could be invested for well over 20 years. Most respondents preferred the lifestyling approach; they saw a “duty of care” responsibility as being too vague. Respondents preferred greater certainty that their investment strategies were consistent with the Government’s and Pension Regulator’s view of meeting their duty of care.

Government Response

104. The Government will report in due course on its decision on the price cap, and consult further on any issues arising from that decision.
105. The Government is attracted to the lifestyling option, and it understands that the majority of providers currently offer some form of lifestyle fund that seeks to reduce the risk of volatility of the fund as the policyholder nears retirement. However, it recognises the dangers of being overly prescriptive in regulation about how this approach is implemented in practice. The Government has decided therefore that the default fund must be designed to diversify assets between stocks and asset classes to balance risk and return with regard to the expected maturity of the investment, and in particular to ensure a reduction in volatility as the investor approaches his or

⁴ A default fund is the fund into which investors who do not make an investment choice are put. For the future, it might be more appropriate to refer to the default fund as the “standard fund”.

her likely retirement date. The Department for Work and Pensions will consult on the exact wording to be used in the stakeholder pension schemes regulations early in 2004.

106. Given that retirement dates are no longer as fixed as they were in the past, such a fund could effectively require firms to disclose in their annual statement the retirement date they are managing the funds towards, and giving investors the opportunity to contact them if this has changed.
107. The Government's objective is to find the right balance between controlling the degree of risk to members without adding to costs. The Government will therefore work with providers over the next few months to see how best to achieve this.
108. Stakeholder pensions should continue to be able to offer a wider range of funds beyond the default option. Monies invested in stakeholder pensions through the FSA's new stakeholder products sales regime will have to be invested in the default fund. After such a sale, policyholders would, as now, be able to change funds on an execution-only basis. If they chose to seek advice, it would be for the customer and those offering advice to arrange for remuneration for this advice, either within the price cap otherwise.
109. The Government wants schemes to be able to move to the new arrangements with the minimum of disturbance and cost. The Government will be discussing with stakeholder pension providers, the FSA and OPRA over the next few months how best to achieve this transition.

Key Points

- **The Government will fold the current stakeholder pension into the new product suite**
- **There will be a requirement to lifestyle the default fund of the product**

9. Branding and Promotion

Consultation Proposal

110. The consultation raised the issue of the most appropriate brand name for the new product range, on the understanding that a successful product launch requires effective marketing in addition to effective design, pricing and distribution. It suggested the working title of “stakeholder products” (the term proposed in the Sandler Review) had inherent appeal in that it is already established as offering low-cost, simple investment products.

Consultation Responses

111. Respondents focused on two aspects of branding: the proposed use of the “stakeholder” name, and the requirement for wider communication/education:

Table 1: Arguments for and against the “stakeholder” brand

For	Against
1. Stakeholder brand already out there and has market currency	1. Implies wrong things e.g. returns guaranteed by Government
2. Stakeholder pension will be in product range	2. Hasn't caught on/could be seen as extending a weak brand
3. Could inject further life into the stakeholder pension	3. Effective brands are functional, literal, positive and straightforward

- *Views were split over the use of the stakeholder brand.* Those in favour agreed that the brand already had a certain currency, and noted that if the stakeholder pension was to be in the product range it made sense to brand the others on the same lines. Broadening the “stakeholder” brand could also inject further life into the pensions product. Those against suggested that the term was opaque, when effective brands were literal, functional and positive, and that it may imply the wrong things (such as guaranteed return).
- *Other names were suggested.* Suggestions for alternatives included Treasury Defined Plans, STEP (Simple, Transparent, Easy to understand Products) and Low Cost Investment Products. Many recommended conducting market research. A minority questioned whether a generic brand name was needed at all given that the product wrappers already have a brand and that a further name could add to confusion, especially if not promoted effectively.
- *Many believe a wider communication campaign is needed.* A large number of respondents argued that the nature and extent of the marketing of the products

was as or more important than their generic name. Many called explicitly for a Government marketing campaign. Some suggested that the focus of such a campaign should be with the specific objective of raising awareness of “stakeholder” products. Others suggested that a broader marketing campaign on the need to save for retirement (following the major Government campaigns on seat-belts, drink-driving and AIDS) would be more desirable.

Government Response

112. The Government accepts that there a number of arguments against the use of the stakeholder brand, and that if there was a “blank canvass” there would be advantage in conducting some market research into the most appropriate brand name. However, given the facts that: (1) the stakeholder pension is going to form part of the product suite; (2) it would add to market confusion by changing the name of these pensions and (3) it would add to market confusion to have more than one brand name for Government-designed product, the Government therefore proposes the generic name of the product to be “stakeholder”.
113. The Government also accepts that there may be a case for some form of extra Government support for the brand it has created, though it expects that firms will engage in their own promotional activities in order to capture market share. The risk that the product could become too closely associated with Government, which could result in consumers thinking the products are in some way underwritten by the Government, must also be considered.
114. At a minimum, further Government support might take the form of a stakeholder logo or symbol, which providers and distributors could use to promote the products. Beyond this, the Government could engage in wider marketing activity. The Treasury will consider developing design proposals for a stakeholder logo, and analyse options for further Government branding, working alongside the COI, FSA and Department for Work and Pensions.
115. The introduction of the stakeholder brand has implications for CAT standards. These were introduced as voluntary benchmarks for ISAs in 1999, and were subsequently joined by CAT standards for mortgages. Both ISA and mortgage CAT standards have sent important messages to the market and to consumers about decent terms and conditions.
116. The introduction of a wider suite of stakeholder products has led the Government to reassess the need for those standards to continue. As regards saving and investment products, the Government believes it makes sense to have only one ‘standard’, and that the CAT concept should evolve with that in mind. This means there is a need to simplify the bench marking structure while taking account of the differences between those two propositions.
117. Accordingly, the Government has concluded that the CAT standard cash ISA will become a stakeholder cash ISA, and will fill an important place in the stakeholder range. The CAT standard equity ISA and CAT standard insurance ISA will be folded into the medium term stakeholder product range

The Government does not propose to remove the CAT standard for mortgages at this stage.

118. The Government is aware that a proportion of current CAT standard products are non-managed funds, and that these funds will not be able to “fold-in” to the stakeholder regime. To the extent that these funds are index trackers, the Government is confident that charges for these products are reasonably competitive and that they are unlikely to creep up in the absence of being marketed under the CAT brand.
119. Firms will, of course, continue to be able to offer products that meet the current CAT standard. The Government recognises the need to ensure that existing savers and investors in CAT standard products are properly informed about the nature and effect of these developments.
120. In order to ensure the effective “folding in” of the CAT standards, and to ensure the new products fully meet the needs of the target market, the Government proposes that the CAT standard feature of “flexibility”, in terms of access to funds and lack of exit charges, be added to the “simple, low cost, risk-controlled” product descriptors of stakeholder products.

Key points

- **The generic name for these products will be “stakeholder”.**
- **The Government will consider whether to provide additional branding and promotion support for the new product range.**
- **The CAT standard cash-ISA will be rebranded the stakeholder cash-ISA, the CAT standard equity-ISA will be replaced by the stakeholder medium term product. The CAT standard insurance ISA will be withdrawn.**

10. Next Steps

121. Respondents to the consultation were concerned that firms should have sufficient lead-time to prepare for the implementation of the suite. There was also a preference for a “big bang” approach, meaning firms would prefer the implementation of the various regulatory changes to occur simultaneously.
122. The Government therefore proposes to introduce the suite in April 2005, approximately one year following the laying of regulations for changes to stakeholder pensions, and simultaneously with the introduction of the Child Trust Fund and the envisaged implementation of reforms to pension taxation.
123. The table below shows a timetable for the activities necessary in the implementation of the product suite. Also included are the other activities that will impact on the industry over the same period.
124. Options are being explored for specifying the standards to give a basis for policing compliance against them through secondary legislation under the Financial Services and Markets Act (FSMA). An announcement on the way forward is planned for Q4 2003.
125. The Government is aware of the potential impact of related policy initiatives such as the Investment Savings Directive (ISD) and is working to ensure compatibility between all savings related policy areas.

Time	Event
Q3 2003	<ul style="list-style-type: none"> • FSA consumer testing of sales process • Publication of full proposals for the Child Trust Fund
Q4 2003	<ul style="list-style-type: none"> • Announcement of further details of plans to reform the taxation of pension schemes
Q4 2003	<ul style="list-style-type: none"> • Announcement of results of consumer testing of sales process • Announcement of decision on price cap • Charge cap research published • FSA Consultation Paper on sales process • HMT consults on regulations to specify products
Q1 2004	<ul style="list-style-type: none"> • DWP consults on stakeholder pension regulations (including transition issues)
Q2 2004	<ul style="list-style-type: none"> • Stakeholder pension regulations laid • FSA rulemaking on sales process • HMT regulations laid
Q2 2005	<ul style="list-style-type: none"> • Implementation of product suite • Possible implementation of reforms to the taxation of pension schemes, including flexible retirement • Implementation of Child Trust Fund

Annex 1: Summary of Response to Questions

Generic

1. The Government welcomes views on the appropriate lead-in time for product development. **The range was from 3 months to 24 months, dependent on the nature of the products. Most requested 9-12 months lead in.**
2. The Government welcomes views on the generic name for the product range. **Views were split as to whether stakeholder was a good brand name.**
3. The Government welcomes views on the likely size and nature of the target market providers envisage for these products. **Many questioned whether the market would be as big as the Government implied, though some felt that there was both mass-market and up-market potential.**

Unitised Product

4. The Government welcomes views on whether we should treat collective investment schemes and life insurance products as one “stakeholder” product. **Most agreed with would be sensible, assuming that it would be possible to change the insurance ISA limit to be the same as that for CIS funds.**
5. The Government welcomes views on whether a 60% maximum equity exposure provides an appropriate level of risk-control for unitised products. **Many felt 60% was an acceptable compromise between risk and return.**
6. The Government welcomes views on whether there should be a minimum level of equity exposure alongside the proposed maximum. **Very few supported a minimum equity exposure level.**
7. The Government welcomes views on whether there should be additional constraints in terms of the permissible portfolio of fixed-income securities. **The majority favoured no additional constraints on these assets.**
8. The Government welcomes views on whether additional diversification requirements are necessary and if so the form and content they should have. **Many supported a principles-based approach to diversification.**
9. The Government welcomes views on the potential of these alternative means for controlling risk. **These were universally rejected.**
10. The Government welcomes views on both the level and the structure of the proposed charge cap. **Nearly all firms favoured a higher charge, with many supporting some form of up-front charge in addition to an AMC.**

With-Profits Product

11. The Government proposes to require a 100/0 fund structure for the with-profits product and welcomes views. **Many supported this.**
12. The Government welcomes views on these options for establishing an explicit management charge. **There was a range of views on this issue.**
13. The Government welcomes views on requiring the maintenance of a separate smoothing account. **Nearly all rejected this.**
14. The Government welcomes views of whether it is desirable to specify parameters within which smoothing can take place and whether this should be done by specifying a single smoothing model or through guiding principles. **Nearly all rejected this.**
15. The Government welcomes views on the relationship between smoothing and guarantees, and in particular whether smoothing is viable in the absence of guarantees and whether guarantees are likely to be viable within a stakeholder with-profits product. **Smoothing is viable in the absence of guarantees, but guarantees are unlikely to be offered within the charge cap.**
16. The Government is interested in views on the implications for funds of disclosing unsmoothed asset share, particularly on the scope of arbitrage. **Many felt that arbitrage could be extensive.**
17. The Government welcomes views on how effective MVAs could be in protecting both funds and remaining policyholders from the effect of selection against the fund. **Most agreed MVAs were very important.**
18. The Government welcomes views on the level and structure of a charge cap for smoothing and guarantees. **Smoothing costs money. Guarantees are unlikely to be offered.**
19. The Government welcomes views on whether the underlying investment fund of the “stakeholder” with-profits product should have the same risk-controls as the “stakeholder” unitised product. **Nearly all agreed.**
20. The Government welcomes views on alternative names for investment products with smoothed returns. **“Smoothed funds” was supported.**

Pensions Product

21. The Government welcomes views on options for bringing stakeholder pensions into the Sandler regime. **Most felt this should be done via use of the default option of the current stakeholder pension.**
22. The Government welcomes views on these three options for investment restrictions and on how a general duty might best be framed, if respondents support it. **The life-styling approach was generally favoured.**

23. The Government welcomes views on providers' experience with previous and anticipated persistency in pension products. **There was a range of views.**
24. The Government welcomes views on whether there are issues unique to pensions in terms of charges. **Many suggested they cost more than CIS funds.**

Other Products

25. The Government welcomes views on including a guaranteed product within the "stakeholder" suite. **Some strongly supported, others strongly rejected.**
26. The Government does not therefore consider there is a good case for including a protection product in the suite of "stakeholder" products. **There was near unanimous agreement.**
27. The Government welcomes views on the advantages and disadvantages of rebranding the CAT-standard cash ISA to make it consistent with the wider "stakeholder" suite and on how this might best be done. **Most felt this would be sensible.**
28. The Government therefore proposes that an annuity should not form part of the "stakeholder" suite of products. **There was near unanimous agreement.**
29. The Government welcomes views on whether an advice service could have a place in the "stakeholder" suite and the form that it might take. **Most felt that as this was not an investment product this would cause confusion.**
30. The Government would be interested in views on whether explicitly linking the CTF to the other "stakeholder" products would be helpful. **Most agreed there should be some links, with some calling for stakeholder and non-stakeholder versions of the Child Trust Fund.**

Annex 2: List of Respondents and Firms Seen

The Government is very grateful to the following organizations and individuals for their responses to the consultation:

ABI
Abbey National
The Actuarial Profession
Aegon
AIFA
AITC
The Alliance
Amicus
APCIMS
Aqera
Association of Friendly Societies
B & CE Insurance
Baillie Gifford
Barclays
Barrie & Hibbert
Beachcroft Wansborough
BPF
BSA
Martin Campbell
The Children's Mutual
CIS
Clerical Medical/Halifax Financial Services
Close Fund Management
Consumers' Association
Egg
F & CE Management
Fidelity
Fitzrovia
Friends Provident
FSA Small Business Practitioner Panel
FSCP
Gartmore
Hargreaves Lansdown
HSBC
Homeowners Friendly Society
ILAG
IMA
Invesco
Investment and Life Assurance Group
Investment By Design
Kevin James
Lambeth Building Society
Law Society of Scotland
Legal and General

LIA
Liverpool Victoria
Marks and Spencer Financial Services
Merrill Lynch
NAPF
National Consumer Council
National Savings and Investments
Nationwide
Norwich Union
OPAS
OPRA
Pensions Institute
Pensions Management Institute
PIMA
Prudential/M&G
Royal London
Sainsbury's Bank
Scottish Widows
SIFA
SOFA
SPC
Skandia
Standard Life
Tayburn
Tillinghast
John Shuttleworth
Tesco Financial Services
Towry Law
Virgin Money
Zurich
Watson Wyatt
Wealth Asset Management