Periodic Report Group 2003

Background Paper

Stakeholder Pensions in the UK

Pensions Policy Institute

PENSIONS POLICY INSTITUTE

PPI

Stakeholder pensions in the UK

Note prepared for the Periodic Report Group by Alison O'Connell, Director of the Pensions Policy Institute, August 2003

1. **The stakeholder pension product in the UK has not been a clear-cut success**. The intention was to encourage new pension savings for people on low to median earnings (£9,000 to £20,000 a year). Although over 1 million stakeholder pensions have been sold, much of this (65% of single premiums) is business transferred from existing pensions, so that new saving has not significantly increased[1]. Total private pension sales now appear to be falling back to pre-2001 levels (see Appendix A).

   There may have been a 'novelty' effect shortly after stakeholder was introduced in April 2001 as advisers suggested the stakeholder product while it was in the news. But it is also thought that a large part of the market, particularly Group Personal Pensions (non-stakeholder) were being re-broked at the same time, because of transfers out of the troubled provider, Equitable Life. It is therefore difficult to isolate what the stakeholder initiative has achieved.

   It is thought that the existence of stakeholder has had a knock-on effect on lower charges in the non-stakeholder pension market. Stakeholder pensions now amount to around 40% of the number of new private pension contracts sold, and around a third of the new premiums[2]. In a stakeholder product charges are limited to 1% a year, and this has forced the industry to examine its cost base. Many non-stakeholder personal pensions are now 'stakeholder – friendly' even if not formally earning that name, with lower charges than they used to have.

2. The **reasons** for the lack of penetration of stakeholder products include: most employers who want to give pensions to their employees have no need of stakeholder; the financial services industry is wary of promoting retail stakeholder products; people in the UK are not interested enough, or cannot afford, to buy stakeholder pensions.

3. **Employers** have a wide choice in pension products if they wish to provide a pension, and those who already provide a pension did not have to provide a stakeholder. All firms with more than five employees have to provide access to a stakeholder, but do not need to make employer contributions. 90% of employer stakeholders are

---

[1] See Association of British Insurers (ABI) November 2002 and House of Commons Work and Pensions Select Committee April 2003 pp. 55-58

[2] PPI analysis of ABI data

empty shells, that is, set up to meet the requirements of the law but with no contributions. There is one best practice role model but only 9% of employers are making contributions to stakeholder schemes (see the B&C example and data in the House of Commons report).

4. The **financial services industry** is wary of promoting stakeholder pensions, for two main reasons. The first applies to all pensions saving in the UK at present: because of extensive means-testing it cannot be said with certainty that it always pays to save. Someone who saves a modest amount may end up with a total pension income no more than his or her neighbour who receives means-tested benefits from the state. The government is trying to overcome this problem, but the solution (Pension Credit) is partial. This means that advisers cannot clearly say whether it is 'best advice' for an individual to save, and given the huge fines some companies have had for mis-selling in the past, they tend to be cautious, and avoid what might be construed as overselling.

   The second is unique to stakeholder and that is the 1% cap on charges. Many companies believe that it is the costs of selling stakeholder products to individuals are higher than this – so that they cannot make a profit on the product unless the customer retains it for an unlikely period of time (12- 15 years has been mentioned). Acquisition costs are high, because attracting customers is difficult (see point 5 below) and because of the cost of the sales process as imposed by regulation that aims to avoid mis-selling. As a result, most financial services companies compete for employer-based stakeholder business. For examples of what financial services companies are saying see *Times* article attached and Norwich Union Press Release 27 March 2003.

   It is a valid question to ask why the financial services companies went along with stakeholder when they knew they could not make a profit from it. Industry gossip suggests that most assumed that the government would eventually make stakeholder compulsory – indeed this was said to be the government's intention until very late in the process of drawing up stakeholder recommendations. Making stakeholder compulsory would obviously increase volumes and reduce acquisition costs significantly so that profits could be made. But given recent stock market volatility, and that the policy debate has moved on, it seems unlikely that compulsion could be introduced in even the medium term.

5. **Individuals** are not interested in pensions at all, and stakeholder does not seem to have made a difference to this. There is great confusion about pensions – not helped by the complexity of UK policy where both state and private pensions are multi-component. The most often given reason for not saving in a pension is 'lack of money' – and the introduction of stakeholder does not solve this[3].

   There is now a 61% awareness of stakeholder in the UK working age population, but half of these have heard of the name only, and a further 30% only know a little about them. Only 3% of working age people say they have taken out a stakeholder pension, although just over 20% said their employer offered one. However, around half did not know whether their employer offered a stakeholder.[4]

6. **Lessons** from the UK stakeholder experience that may be useful for the New Zealand situation include:
   - **It cannot be assumed that, even though government thinks it is a good idea for a product to have certain features, suppliers and customers will embrace the product.** In the UK, there is little enthusiasm for stakeholder, even though it is simple, cheap, and like all private pensions, attracts tax relief.
   - **The purpose of government intervening in the private pensions market has to be clear**. Is it to pave the way for compulsory saving, is it to facilitate new saving because the financial services industry is not providing what customers want, or is it to encourage people who 'should' be saving even though they do not want to? In the UK, it was not really clear, but the latter reason comes closest. However, it does not seem to have resulted in significant new saving.
   - **Government should be sure that the problems that stakeholder is introduced to solve are really solvable by stakeholder**. In the UK, the problems include: many people do not have enough money to save; many employers are not willing to provide sufficient pensions; the complexity and inadequacy of the state pension system. It is now more important to solve these problems (and stakeholder cannot solve them) than make stakeholder work.

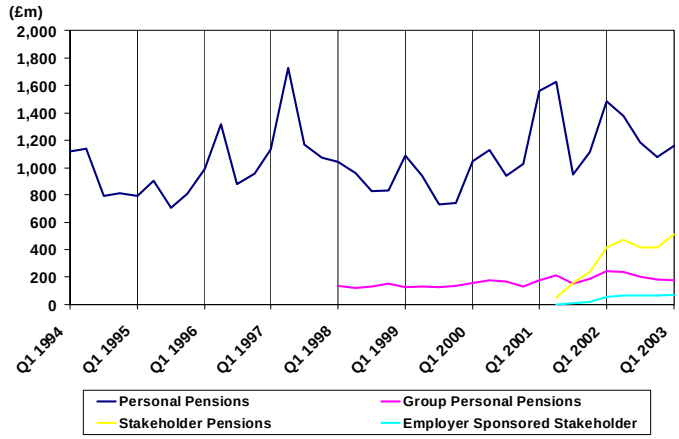
---

[3] For more on pension buying (or not buying) behaviour, see Curry & O'Connell (2003) pp. 54-56

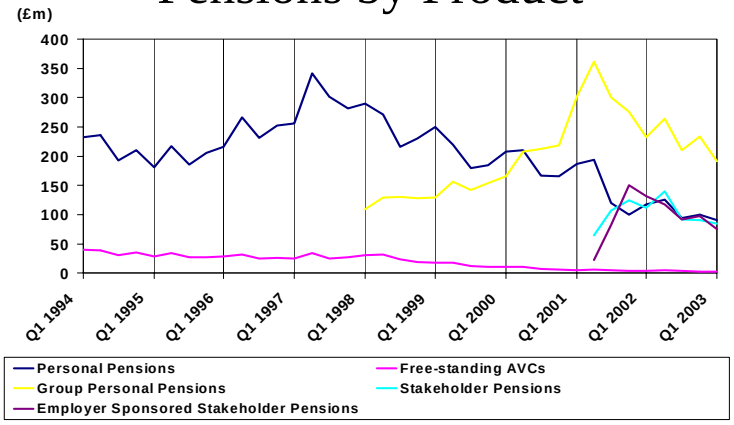
[4] All these statistics, and a useful description of the characteristics of the stakeholder target group in Mayhew (2003)

Appendix A: Trend in new pensions premiums (from Association of British Insurers statistics)

Single Premium Individual Pensions by Product



Regular Premium Individual Pensions by Product



Appendix B: Article from *The Times* 4 August 2003

Stakeholder plan blamed as pension sales collapse

BY ANTONIA SENIOR

THE crisis gripping Britain's troubled pension fund industry is set to deepen amid signs that sales of retirement products to individuals collapsed by more than a third in the first six months of the year.

Analysis of the industry's first-half results reveals that new premiums fell 32 per cent at the interim stage, against the same period last year. The dramatic fall is likely to add to fears that workers are not doing enough to prepare for their retirement.

Industry experts blame the Government's introduction of stakeholder pensions in April 2001. Under the initiative, insurers were encouraged to launch a low-cost product aimed at low-income earners, and known as a stakeholder pension. To keep a lid on costs, insurers were told that they could charge no more than 1 per cent a year to manage the funds backing the policies.

Sales of other types of pension have since collapsed, largely because independent advisers are worried that they may lay themselves open to charges of mis-selling if they recommend to clients any type of product other than the lowest-cost option.

Iain Lumsden, chief executive of Standard Life, which sells mainly through independent financial advisers (IFAs), said that middle-income earners were hardest hit by stakeholder pensions' introduction.

He said: "Price caps are an issue because IFAs can't afford to give advice on the kind of commissions we can afford to pay, so they are moving to other more profitable lines of business, such as protection. There is no point in pretending that IFAs can afford to give advice to middle-income earners. It would be helpful overall if the Government recognised that we can't sensibly serve middle-income earners with stakeholder price caps."

Insurers with direct sales arms say they cannot afford to market stakeholder schemes because of the tight margins. A stakeholder pension with low premiums takes at least 20 years to become profitable.

The Government intends to introduce a range of investment products based on the stakeholder design. Details of the products — suggested by Ron Sandler's review of retail savings — have been unveiled, but ministers have yet to say whether costs will be capped.

Oliver Heald, Conservative spokesman on pensions, called for reform of stakeholder rules. He said: "The combined effect of the lack of incentives to make pension provision, the spread of means-testing and the 1 per cent charge cap is inhibiting the ability of insurance companies to sell pension products other than to people on high incomes."

References

Association of British Insurers November 2002 *Stakeholder Pensions-Closing the Savings Gap?* www.abi.org.uk

Curry C. and O'Connell A. (2003) *The Pensions Landscape* Pensions Policy Institute www.pensionspolicyinstitute.org.uk

House of Commons Work and Pensions Select Committee *The Future of UK Pensions* April 2003 http://www.publications.parliament.uk/pa/cm200203/cmselect/cmworpen/92/9210.htm#a29

Mayhew V. (2003) *Pensions 2002: Public attitudes to pensions and saving for retirement* Department for Work and Pensions Research Report 193 London: Her Majesty's Stationery Office

Norwich Union press releases at http://www.aviva.com/news/news.cfm?media=yes