briefing notes

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THE GOVERNMENT'S PROPOSALS FOR STAKEHOLDER PENSIONS

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Briefing Note No. 1

Published by
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© Institute for Fiscal Studies, October 1999

ISBN 1-903274-02-8

Published online at http://www.ifs.org.uk

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October 1999

Introduction

Published in December 1998, the government's consultation document *Partnership in Pensions* contained proposals for stakeholder pensions to be introduced in April 2001.[1] Targeted at full-time workers earning between £9,000 and £18,500 a year who do not already have a private pension, stakeholder pensions are intended to increase the level of private pension provision among this group. The perceived problem is that not all employees have access to occupational pension schemes, while personal pensions may not be good value for money because of their high upfront charges. Stakeholder pensions will offer a 'low cost, flexible and secure' alternative.[2] Like all personal pensions, and some occupational pension schemes, stakeholder pensions will be defined contribution schemes. But they will have compulsory minimum standards, guaranteed employer access and a different governance structure. Since June 1999, six discussion papers have been published with further details on different aspects of stakeholder pensions. These cover:

- minimum standards;
- employer access;
- clearing arrangements;
- regulation, advice and information;
- governance;
- the tax regime.

This note assesses each of these discussion papers in turn, summarising their main conclusions and critically appraising the proposed stakeholder reforms.

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[1] See R. Disney, C. Emmerson and S. Tanner, *Partnership in Pensions: An Assessment,* Commentary no. 78, Institute for Fiscal Studies, London, 1999, for an assessment of the initial proposals. The executive summary is available at http://www.ifs.org.uk/research/pensionsandsavings/partnership.shtml.

[2] Department of Social Security, *A New Contract for Welfare: Partnership in Pensions,* Cm 4179, DSS, London, 1998. This is available at http://www.dss.gov.uk/hq/pubs/pengp/index.htm.

Minimum standards

Proposals for minimum standards

Charges
- A single percentage charge on the value of the fund, to cover all normal operating costs and basic explanation and advice, subject to later consultation.
- Total charge to be limited to 1 per cent per annum.
- Any additional services to be paid for separately, but must be discretionary.

Minimum contributions
- No higher than £10, for either regular or one-off contributions.
- No minimum frequency of contributions.

Investment
- A clearly defined default investment choice.
- With-profits investments should allocate all funds to scheme members.

Information
- Same as for other money purchase pension schemes.

Transfers
- No additional charges for transfers into or out of stakeholder schemes.
- Schemes must accept transfers of pension rights from other schemes, in so far as this is consistent with the requirements for tax approval.

Tax approval
- Schemes must be tax-approved by the Inland Revenue.

One of the reasons for imposing a uniform charging structure is to allow consumers to make cost comparisons between different schemes more easily. One perceived problem with existing personal pensions is their complexity. The fact that different providers may charge on different bases means that direct comparisons between the costs of different pensions on offer are not straightforward. This reduces the downward competitive pressure on costs since individuals will be less likely not to choose high-cost providers. If all stakeholder pensions have to have the same charging structure, this will allow people to make comparisons between the charges imposed by different providers more easily and should increase competitive pressure on costs.

There are a number of options for a uniform charge that the government could have chosen, including a fixed charge, a percentage of total contributions or a percentage of the total value of the fund. The actual costs of running a pension are likely to include both a fixed component (which will be particularly high at the start when the fund is being set up) and a variable component depending on the level of contributions and/or the total size of the fund. However, the trade-off in having a more complicated charging structure – for example, an annual fixed cost and a percentage of total contributions/

fund – which might more closely reflect the nature of the costs involved is that it would reduce the transparency of the schemes' charges.

Personal pensions have been criticised for imposing high upfront charges that effectively tie scheme members in, making it expensive for them to switch to different providers later on. Instead, the government wants stakeholder pensions to levy an annual charge as a percentage of the individual's total fund. There are two main reasons given for this.

First, it is argued that charging a percentage of fund value provides a greater incentive for schemes to maximise investment returns compared with charging a proportion of contributions or a fixed annual fee. Given regulation over the level of charges (see below), schemes will be predominantly competing on investment performance anyway, which the publication of 'league tables' by the Financial Services Authority should help to reinforce. In practice, fair interpretation of 'league tables' showing each fund's return net of costs may be extremely difficult since an adjustment for risk should be made. Otherwise, it is likely to be the funds that invest in the riskiest assets with the highest expected returns that appear to perform best, but these funds may not be suitable for everyone.

Second, charging as a proportion of fund value, rather than contributions, provides schemes with a smoother flow of income if scheme members take contribution breaks. Previous analysis of the characteristics of the stakeholder pension target group shows that middle earners who do not already have a private pension are much more likely than those who do to experience periods of unemployment, suggesting that they are likely to take contribution breaks.[3]

However, setting charges as a percentage of the total value of the fund will not generate a lot of revenue for scheme providers early on when funds are likely to be small. Since the government has also imposed a maximum limit on the percentage of the value of the fund that can be charged (see below), stakeholder pensions are likely to be loss-making at the start. One possibility is that stakeholder pensions might try to encourage existing occupational or personal pension holders to transfer their funds. Or they may engage in cherry-picking; that is, they may select employers with the most profitable consumers who are likely to make the biggest contributions early on.

If there is both a fixed and a variable component to the cost of running a pension, then choosing either a fixed annual fee or a percentage charge on contributions/ fund value will result in cross-subsidisation between scheme members. In the case of a fixed annual fee, small funds will subsidise larger funds. By contrast, charging a percentage of fund value means cross-subsidisation from large funds to smaller funds, assuming that stakeholder providers do not decide to vary their charges by fund size. Typically, in a mature scheme, this will mean older members subsidising younger members at any point

[3] See R. Disney, C. Emmerson and S. Tanner, *Partnership in Pensions: An Assessment*, Commentary no. 78, Institute for Fiscal Studies, London, 1999. The executive summary is available at http://www.ifs.org.uk/research/pensionsandsavings/partnership.shtml.

in time. If people tend to stay in a stakeholder scheme throughout their working lives, this will tend to average out over their lifetimes.

As well as imposing a uniform charging structure, the government has specified a maximum annual charge limit of 1 per cent of the total value of an individual's fund. This is intended to cover the costs of:

- establishing and running the scheme;
- investment;
- basic information and advice.

The argument for having a uniform charging structure is to facilitate comparability between different providers and switching away from high-cost schemes. However, if this means that stakeholders will compete effectively on cost, what is the argument for having a regulated maximum charge? The fact that the government is also regulating the level of costs may mean that it does not think that a uniform charging structure is enough to ensure competition. (We return to this issue later on.)

Of course, it could be argued that there is no disadvantage to setting a maximum charge. However, if there is a link between cost and expected return,[4] then a limit on charges, if it is set very low, may also be a potential limit on the investment strategies that schemes can offer. Stakeholder schemes are required to offer a default investment strategy, but it is a matter of choice whether they offer alternatives. A low level of charges may make it more likely that stakeholder schemes offer only the single default strategy. Not only does this mean that stakeholder pensions might offer an investment strategy that is not suitable to all members, but it is also likely to mean that all stakeholder pension schemes will be virtually identical. On the other hand, enabling schemes to offer different investment strategies may mean setting a maximum charge that is fairly high and hence unlikely to be genuinely binding. Also, setting a low maximum charge may put a limit on the number of providers that the market can sustain, given the necessary economies of scale to meet the charge limit.

[4] Preliminary work by Axia Economics suggests that this may be the case (see http://www.axiaecon.com/axia1.htm for further information).

Employer access

Proposals for employer access

Compulsion
Employers are required to designate a stakeholder pension that all employees can join. They must provide sufficient information for employees to contact the scheme. They are not liable for the scheme's performance.
Exceptions where

- all employees have earnings below the NI lower earnings limit;
- all employees are able to join an occupational scheme within six months of starting;
- employers offer a group personal pension that meets certain standards.

Consultation
Employers are required to consult work-force (or representatives) on the choice of stakeholder scheme.

Payroll deductions
Employers must make payroll deductions to that scheme and pass on contributions within 19 days of the end of the month. Employees are limited to contributions changes through payroll at three-month intervals to keep down costs to employers.

Staged introduction of stakeholder pensions
Allowing a year from the introduction of stakeholder pension schemes for employers to make arrangements, before the requirement comes into force.

The requirement for all employers to designate a stakeholder scheme and pass on contributions from their employees does impose an additional burden, which is likely to be proportionately greater for small employers. However, exempting small employers would mean denying employer access to precisely those people at whom the stakeholder pension is targeted. Evidence from the British Household Panel Survey, for example, shows that 45 per cent of those in the stakeholder target earnings range (£9,000–£18,500) who do not have a private pension work for an establishment with fewer than 25 employees, compared with 26 per cent of those who do have a private pension.[5] It is worth noting a problem of a slightly different sort associated with employer size – that there may be some small employers that stakeholder pensions will not have as members.

The chief benefit of employer access is that it will simplify the decision to save in a pension. Individuals will not have to decide which scheme to contribute to, and making regular contributions will be straightforward. A second advantage is that employer access could potentially reduce some of the costs of marketing and administering pensions, at least in the longer term. In the shorter term, there is likely to be a fairly frenzied period of marketing activity directed at employers, each of which represents a potentially greater prize to stakeholder pension schemes than do individuals. The government sees this competition for employers as having potentially desirable consequences – stakeholder

[5] Authors' calculations using the British Household Panel Survey from 1992 to 1995.

pension schemes helping employers set up payroll deduction schemes and carrying out employer-education programmes, for example, although much of this help is likely to be targeted at potentially more lucrative larger employers. Finally, the employer access requirement may encourage employers to make contributions to their employees' pensions. Of course, employees are unlikely to gain from the full amount of any contributions – lower wages are also likely to be a result. But employees may welcome this 'forced saving' (this assumes that people would like to save for their retirement but do not have enough self-control to be able to do it for themselves out of their own wages). In addition, the fact that employers' pension contributions are made before tax and National Insurance means that there is a tax advantage to employer over employee contributions.[6]

A potential problem with employer access is that employers have no incentive to choose a stakeholder scheme that is in the best interests of their employees. There is a requirement for employers to consult their employees (or their representatives), although the discussion paper also makes it clear that the final choice rests with the employer. In effect, this makes the consultation requirement unenforceable. Employers have no incentive to find the scheme that is best for their employees and every incentive to find the scheme that gives the most assistance with set-up costs. This will reduce the burden on business, but there is a danger that help with setting up becomes an outright bribe (an offer of a PC, for example). Rightly, employers are not liable for the performance of their designated stakeholder pension schemes. However, this gives them no incentive to designate the best-performing stakeholder pension scheme at the outset nor to switch to a different stakeholder pension if the designated scheme performs poorly.

The employer access requirements do not apply during the first 12 months, i.e. until April 2002. This seems to add unnecessary complication to the reform process, which is already proceeding in a number of different stages. The change from SERPS to SSP, the introduction of stakeholder pensions and the final transition to flat-rate SSP are all due to be implemented at different dates. Moreover, delaying the employer access requirements could lead to two potentially undesirable outcomes.

1. Individuals start to purchase stakeholder pensions from April 2001 before their employer designates a scheme. From April 2002, a lot of employees could find themselves working for employers with a different designated scheme from the one they joined themselves. This could result in a lot of switching if individuals prefer to have their contributions deducted from their pay-packet. Changing schemes will be nominally costless to the individual, although in reality it is likely to impose a cost on the stakeholder scheme that will eat into the 1 per cent maximum charge.

2. Absolutely nothing happens for a year, since individuals decide to wait until their employer designates a scheme. Providers could even decide to wait until close to

[6] See C. Emmerson and S. Tanner, 'A note on the tax treatment of private pensions and Individual Savings Accounts', *Fiscal Studies*, vol. 21, pp. 65–74, 2000.

April 2002 before marketing stakeholder schemes, since marketing to employers could prove more lucrative than marketing to individuals. This means that individuals may delay their retirement savings decisions for another year or take out a personal pension, potentially with upfront costs, which they might then want to transfer into a stakeholder scheme.

Clearing arrangements

Proposals for a clearing-house

- There should be a simple and cost-effective mechanism for employers to pass contributions to stakeholder pensions on to different providers.
- However, the option for a dedicated clearing-house for stakeholder pensions should not be developed further at this stage. Instead, current commercial clearing facilities could be used, available through the commercial banks, bureaux and BACs.

Effective competition between different stakeholder schemes requires that individuals can switch between different schemes costlessly (this is particularly important since employers will not have any incentive to switch). One of the specified minimum standards is that there should be no explicit charge on transfers of funds between schemes. However, not only must people be able to transfer their funds at no extra cost, they must also be able to contribute to a different fund at no extra cost. If the employer designates a single scheme with a dedicated payroll deduction facility, the incentive to the individual to switch to a different scheme is reduced because they would lose the option of payroll deductions. Setting up a clearing-house would allow employers to make a single pooled contribution from their employees to a number of different schemes and employees would be able to switch schemes without losing the ability to make payroll deductions. However, it is worth pointing out that there may be a potential downside to individuals having 'too much choice'. With the clearing-house in place, employers might avoid the need to select a single stakeholder provider by designating all schemes, leaving the choice of which stakeholder scheme to join to individuals rather than employers.

The biggest argument against a clearing-house is one of administrative cost. However, it is not essential that a clearing-house is profitable in its own right, purely that the costs are outweighed by the benefits of increased competition in the stakeholder pension market. There are, for example, several public/private options for a clearing-house that are not explored in the discussion paper. For instance, it could be a separate public corporation, or one administered by the Contributions Agency or the Inland Revenue. If the scheme were to be privately operated, the government could guarantee it either a share of the contracted-out rebate paid into stakeholder pensions or a percentage of the total stakeholder funds if it was felt that this was necessary to ensure it was financially viable as a private company and that the costs were shared among stakeholder pensioners.

Regulation, advice and information

Proposals for regulation, advice and information

Regulation

The regulation of stakeholder pensions will be split between the Occupational Pensions Regulatory Authority (OPRA) and the Financial Services Authority (FSA).

OPRA will regulate the operation of stakeholder pension schemes, including their compliance with the registration requirements.

FSA will regulate the marketing of schemes and the provision of advice.

The regulation of schemes set up under any alternative governance structure that may be approved will be determined as part of the development of proposals for an alternative.

Advice and information

Within the 1 per cent charge, stakeholder schemes must provide information about the scheme's key features; projections of potential benefits; 'generic' advice on the suitability of stakeholder schemes for different types of individuals; an indication that people who are uncertain should seek further advice.

Any charges for advice beyond this minimum will be expressed in terms of a fee.

There will be a 14-day cooling-off period for anyone joining a stakeholder scheme.

Decisions about saving for retirement are important and complicated. People are likely to need some information and/or advice about the form in which to save and how much to save. The government wants to achieve three outcomes in terms of the information and advice that people get. First, it wants everyone to have basic information about the choices on offer. Second, it wants people to have enough information to know when they need to seek further advice. Third, it wants advice to produce the appropriate recommendations given the individual's circumstances.

Some basic information will be provided by the Department of Social Security and by the Financial Services Authority. But this is not intended to be sufficient to allow people to decide about their pension needs nor to choose between different pension schemes. Instead, most information will come from stakeholder schemes. Providers will be required to give basic information about the key features of their schemes and also to give people a 'decision tree' as a guide to helping them make retirement savings decisions.

Decision trees are intended to provide generic information about the suitability of stakeholder pension schemes for different groups of people. Inevitably, however, the decision tree will have to be fairly simple and there will be many people who do not fit neatly into any of the boxes. However, the decision tree may still be useful if it points people in the appropriate direction for further advice. There is an obvious danger that, in an attempt to avoid subsequent liability, all branches of the decision tree will lead to a recommendation for people to take further advice. Even so, the decision tree may still be helpful in determining the subject areas in which people need to seek advice.

One potential problem with the current proposals is that stakeholder schemes have been given responsibility for producing the decision trees. The Financial Services Authority will devise a decision-tree template, but individual schemes will be able to produce their own customised trees. This might allow schemes to tailor the decision trees more efficiently to their potential market. But it should not detract from the purpose of the decision tree, which is to give generic advice to people about their pension options. There is an important role for the FSA in ensuring that all decision trees contain this advice, and possibly a role for the FSA in providing the decision tree that guides people through their options before they think about going to a particular stakeholder scheme.

There is clearly a trade-off in deciding the level of information and advice that should be made compulsory for stakeholder schemes to provide. There is a potential dead-weight loss associated with giving people 'too much' advice. For the people who do fit generic types, for example, a decision tree may be sufficient to allow them to make the right pension choice. Those who do not need a lot of advice will end up subsidising those who would have paid for additional advice anyway. However, if the compulsory minimum level of information and advice is set low, there is a danger that people will not purchase enough additional advice to enable them to make the right pension choice. Of course, there is an incentive for people to purchase additional advice if they know that they require it. But they may not know whether they need further advice and even if they know they need advice, they may not know whether they are getting the right level, or the right type, of advice. Decision trees could potentially help people with the first of these problems. The second problem is intrinsic to the nature of advice. People seek advice because they do not have enough information to make informed decisions themselves: this makes it difficult for them to evaluate the advice they are given, except in the light of subsequent experience. In the case of pensions, however, the consequences of the advice are only likely to be realised a long way into the future. Appropriate regulation of advisers is one way of trying to overcome the problem, although getting people to trust advisers even if they do give the right advice may be a further difficulty.

Governance

Proposals on governance

Trust-based schemes

Trustees have responsibility for ensuring the scheme conforms to the conditions for registration as a stakeholder scheme. The trustees are ultimately financially liable for the operation of the scheme. However, they are free to contract with financial service providers for such periods as they see fit. There are no specific requirements on member-nominated trustees or appointment of professional trustees, although the government is consulting further on whether a proportion of trustees should be independent of financial service providers. The cost, including trustees' remuneration, will be covered by the 1 per cent annual charge. Schemes will be able to restrict membership to specific groups.

Stakeholder manager

The discussion paper also contains proposals for a secure stakeholder manager as an alternative to a board of trustees. This would be a firm authorised by the FSA that would be responsible for compliance with the minimum standards, determining the default investment strategy and reporting to individuals on the value of their funds. Individual scheme members' rights would be governed by a contract with the stakeholder manager.

The trustees' role is to monitor a stakeholder scheme's performance. However, the trustees must also have an incentive to ensure that the scheme runs in the members' interests. Ultimately, they are financially liable for the operation of the scheme, although in practice they are likely to be able to insure themselves. In any case, personal liability could result in them making extremely low-risk (and possibly low-expected-return) investment decisions ('reckless conservatism').

Without a well-designed incentive for trustees to act in the interests of scheme members, there is a danger of 'regulatory capture' – that is, trustees serving the interests of the financial service providers. This potential problem is likely to be greater in the case of stakeholder pensions that are set up by financial service providers who then appoint the trustees. The alternative model is one where trustees representing a sponsoring organisation, such as a trade union, appoint a financial service provider. In this case, the trustees are independent of the financial service provider from the outset. In both cases, trustees have the power to contract with different financial service providers. However, there clearly needs to be a limit on the extent to which trustees can do this in the shorter term to ensure that financial service providers who bear the initial start-up costs can secure some of the rewards.

Several practical objections were raised to the idea of trustees, including their cost and the potential problems in finding enough suitable and willing members. The government believes that the costs of trustees will not be prohibitively large, given that they will be shared among a large number of members. However, the government's example of a scheme with an average fund of £20,000 per member is unlikely in the short to medium term. Finding enough qualified and willing trustees is likely to depend on the number of stakeholder schemes that are set up.

The tax regime

Proposals for the tax regime

The regime for stakeholder pensions will be based on the existing tax treatment of personal pensions. Contributions (up to an annual limit) and returns will be tax-free. Pensions will be taxed with the exception of a tax-free lump sum worth up to one-quarter of the value of the fund.

The same limits on tax-free contributions will apply to stakeholder pensions and personal pensions (and defined contribution occupational pension schemes if they choose). The annual limit will be *either* £3,600 *or* the existing age- and earnings-related limit, whichever is higher. Individuals will be able to continue contributing the higher age- and earnings-related contributions for up to five years after they stop earning. The current carry-back/carry-forward arrangements for tax relief on contributions will be abolished.

All contributions will be made net of tax. Pension providers will recover the basic rate of tax. Higher-rate taxpayers will be able to recover higher-rate relief through their annual tax returns.

The original Green Paper proposed different tax treatments for stakeholder pensions and personal pensions. Tax relief on contributions to stakeholder pensions would apply to a flat-rate £3,600 a year, while the age- and earnings-related limits would continue to apply to contributions to personal pensions. The problem with having two different tax regimes is that differences in the tax treatment of contributions, rather than any underlying differences between stakeholder pensions and personal pensions, would affect whether people take out a stakeholder pension or not. The decision to apply the same limits to stakeholder pensions and personal pensions is very welcome.

The proposals break the link between tax relief on contributions and current earnings in most cases. For people contributing less than £3,600, the flat-rate contribution threshold applies irrespective of the individual's level of earnings (and, indeed, whether the person is earning at all). For people wanting to contribute more than £3,600, the age- and earnings-related limits apply. However, it is possible to continue to contribute at this level for up to five years when earnings cease (again breaking the link between current earnings and contributions). The proposals are good news for people who want to continue contributing to a pension even when they are not working (although, in practice, this may be of most benefit to high earners with non-working spouses who have already used up their own tax-free contribution limits or who want to maximise the value of their joint personal allowances in retirement; in both these cases, the overall effects are likely to be relatively small).

The proposals simplify the administration of tax relief on pension contributions. Since the link between earnings and contribution limits has been broken in most cases, it is no longer necessary to have confirmation of earnings. It makes sense for individuals who want to contribute more than £3,600 to provide the necessary information on their age and earnings. Limiting relief to the basic rate in the first instance also simplifies administration of tax relief, although it means higher-rate taxpayers losing out on the

returns that would have accrued during the year on the difference between the higher and basic rates of tax. However, higher-rate taxpayers already benefit from the fact that some of their tax is paid, on average, 15 months after the income is received.

The government is currently opposed to dual membership of defined benefit occupational pension schemes and stakeholder pensions. The principal argument is that it does not represent good value for money. People in defined benefit occupational pension schemes already have the opportunity to make additional voluntary contributions (AVCs) which few people do up to the maximum. Allowing contributions to a stakeholder pension alongside AVCs is likely to benefit mainly richer individuals – not the stakeholder target group. Instead, people can choose either to freeze their stakeholder pensions (without any penalty) or to contribute the balance into the defined benefit plan. However, allowing people to continue to contribute to a stakeholder plan alongside membership of a defined benefit plan would allow them greater flexibility in their pension arrangements. It would avoid people building up a multiplicity of small pension entitlements from different sources over their lifetimes (by allowing people to continue to contribute to their stakeholder pension rather than making AVCs). In addition, individuals may get into the habit of making contributions to their stakeholder pension and hence allowing individuals to continue with their existing arrangements may lead to more pension saving. This could be particularly relevant to the stakeholder pension target group, given that they are more likely to experience fluctuations in their employment status.

Conclusions

Partnership in Pensions heralded stakeholder pensions as a radical new form of pension. As many pointed out at the time, stakeholder pensions were rather less radical than the government claimed. In essence, what the government's proposals outlined was a bench-marked personal pension together with a requirement on employers to make private pension provision more easily available to their employees. The subsequent discussion papers, which have fleshed out stakeholder pensions in more detail, have reinforced this view. The requirement that stakeholder pensions must have a board of trustees has been toned down by a commitment from the government to look at alternative governance models, including a secure stakeholder manager. Stakeholder pensions are not going to have a different tax regime from personal pensions – they will both have the same tax regime. The exemption from having to offer stakeholder pensions has been extended to employers offering group personal pensions. And, with many private pension providers already offering personal pensions that meet the minimum stakeholder standards, the distinction between personal and stakeholder pensions has become even more blurred.

The changes to the proposed tax treatment of stakeholder and personal pensions are extremely sensible. Otherwise, people's pension choices would have been determined by differences in the tax-free contribution limits between the two as well as by underlying costs and performance. Also, as stakeholder and personal pensions become more similar (and potentially even merge into one pooled pension investment), the government may be able to achieve its desired goal of simpler, cheaper and more flexible defined contribution private pension plans without introducing unnecessary additional complication and inducing suboptimal switching. However, this requires the language of pension reform to be toned down, as well as the government reducing the real differences between the two types of schemes.

What is the potential impact of stakeholder pensions? The ideal scenario would be one where several providers offer stakeholder schemes that are cheaper and more flexible than existing personal pensions, with cost reductions coming from increased competitive pressure, as well as simpler administration through employers. In the ideal world, individuals are able to make the right pension choices on the basis of information received through the government, employers and/or stakeholder providers, can easily compare the costs of different schemes and can costlessly switch to alternative providers. Also, people without stable employment are not penalised for stopping and starting contributions into their private pensions by high upfront charges. In this competitive scenario, there is less need for direct government regulation – for example, of the level of costs that stakeholder schemes can charge.

But consider an alternative scenario. Given a potentially small target group and revenues that depend on fund values, providers offering stakeholder schemes could have very low incomes for several years. This means that there may only be a limited number of entrants. In fact, the degree of competition in the market is likely to depend as much on

the threat of employers and individuals switching between different schemes as on the number of schemes *per se*. One potential problem is that employers have no incentive to change providers once a designated payroll deduction facility has been set up, while employees may find it more difficult to contribute to a scheme not designated by their employer. This would provide each stakeholder pension with an almost-guaranteed stream of customers. Any switching activity will be linked to employment change rather than to different schemes' performances. In this scenario, responsibility for monitoring the performance of stakeholder schemes and for switching financial provider in the event of poor investment performance will be borne by the trustees of the scheme who are liable for its performance, although there is a potential danger of regulatory capture, i.e. that the trustees will pay more attention to the interests of the stakeholder provider than to those of the individual scheme members. In the absence of effective competition in the market, there is a greater need for government regulation. However, the danger with direct regulation is that stakeholder pensions become a low-(regulated)-cost/low performance pension option.