Supporting automatic enrolment:

A call for evidence on the impact of the annual contribution limit and the restrictions on transfers on the National Employment Savings Trust

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Department for Work and Pensions

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Foreword by the Minister of State for Pensions

Automatic enrolment will make pension savings the norm for millions of people. This is vital for the health of our society and our economy. But to successfully achieve this behavioural shift, we need to make sure that the pension system works in the interest of individuals, helping them to achieve a decent standard of living in retirement.

This call for evidence explores questions raised by the Work and Pensions Select Committee about the impact that two of the constraints on NEST – the annual contribution limit and the restrictions on transfers - are having on employer choice and whether they work as the policy intended.

I am keen to ensure that any barriers, or perceived barriers, to employers having access to a low-cost, high quality scheme are swiftly responded to. It is critical to the success of automatic enrolment that employer choice leads to individuals getting a good deal when saving for their retirement, provision that is suitable for their savings needs, with charges that offer good value for money.

We do not want the achievement of automatic enrolment to be undermined as a consequence of employers' perceptions that the annual contribution limit and the transfer restrictions on NEST are complex and costly to administer. This could adversely affect outcomes for individuals. However, evidence that these two constraints are acting as a barrier to employers choosing NEST is not unequivocal and the Government is conscious that the annual contribution limit and the restrictions on transfers are intended to play a role in ensuring NEST remains focussed on its target market and complements existing good quality pension provision.

As automatic enrolment has become a reality, this paper explores how the supply side landscape has evolved, and how the factors that affect employers' choice of scheme can be driven by motivations which do not necessarily align with those of their workers. It seeks views and evidence on whether the policy for the annual contribution limit and the restrictions on transfers continue to work as intended or whether the Government should consider alternative approaches to address the concerns raised by the Committee - especially as smaller employers start to engage with the reforms.

I look forward to comments submitted in response to this call or evidence. As the paper sets out there are a lot of questions for us to answer before deciding whether or not there is a case for change, and if so that any action we take is fully informed by the views and evidence of employers, industry, consumers and their representatives.

Steve Webb MP
Minister of State for Pensions

Executive Summary

Introduction

1 From July 2012, individuals started to be automatically enrolled into their employers' pension scheme. This will help 6-9 million people save into a pension for the first time, or save more into their existing scheme.

2 The National Employment Savings Trust (NEST) was established to underpin automatic enrolment and has a key role to play in making the workplace pension reforms a success. We estimate that 2-4 million people will be enrolled into NEST by the end of implementation.

3 NEST was designed to fill a gap in the market and ensure that everyone eligible for automatic enrolment could access a low-cost pension scheme. This design, however, also imposed a unique set of constraints on the scheme:

- it must accept all individuals automatically enrolled into it, even if the charge income derived from the individual does not cover the cost of their account - this is expressed through the public service obligation
- it must offer good value, offering a charge level comparable to those available to high earners and those working for large employers – a low-cost objective
- it cannot offer other products – ensuring simplicity, and
- it must target a group of low to moderate earners, smaller employers and employers with a high labour market churn who commercial providers found it difficult to serve profitably – to provide a focus on this group two statutory constraints were placed on NEST, an annual contribution limit[1] and restrictions on transfers into and out of the scheme.

4 The Work and Pensions Select Committee recently conducted an inquiry into automatic enrolment in workplace pensions and the National Employment Savings Trust. The inquiry examined the implementation of the reforms to ensure that they would be delivered effectively and in the best interests of workers and employers. It published its final report on 15 March 2012[2].

5 A key area the Committee examined was the likely impact of NEST's annual contribution limit and restrictions on transfers. The Committee received evidence indicating that these two constraints might have unintended consequences, suggesting that:

[1] In 2012 earnings terms, the annual contribution limit is £4,400
[2] Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12

- the annual contribution limit would result in severe complexity for businesses, as it would mean that employers with higher paid workers could not use NEST as their single pension scheme
- the restrictions on transfers were a disincentive and additional cost for employers who would like to operate a single occupational pension scheme, and
- the restrictions on individuals transferring pension funds into and out of NEST would disadvantage individuals who would like to consolidate separate pension pots.

6 The Committee concluded that these constraints may prevent NEST from addressing the market failure it was designed to address. It recommended that the Government should remove the annual contribution limit and the restrictions on transfers as a matter of urgency. However, evidence that NEST's annual contribution limit and the restrictions on transfers are acting as a barrier to employers choosing NEST is not conclusive.

7 This call for evidence is therefore seeking to inform our evidence base and policy on the impact of these two constraints. It looks at the policy background to NEST and the intention behind setting the annual contribution limit and the transfer restrictions. It sets out our analysis of the issues and invites views and evidence from employers, pension providers, individuals and their representative groups pertinent to whether the annual contribution limit and the transfer restrictions work in the way that they were intended, or whether there is a case for change.

The Supply Side Landscape

8 Chapter 3 explores how the supply side landscape has evolved since NEST was established and how commercial providers have responded to automatic enrolment. It considers whether the annual contribution limit and transfer restrictions are affecting the overarching policy intent for NEST that everyone eligible for automatic enrolment could access a low-cost pension scheme.

9 It sets out what we know about the factors that affect a pension provider's ability to supply a suitable, low-cost workplace pension to different types of employer. It explores the capacity of the pension industry to meet unprecedented peaks of demand as the number of employers seeking to meet their automatic enrolment duties ramps up.

10 Although some providers have indicated a willingness to supply workplace pension provision at scale and to the smallest employers at low-cost, unlike NEST they are not obliged to do so. The paper therefore seeks evidence on the extent to which commercial providers are able, and willing, to supply a suitable low-cost pension product to a diverse range of employers, and whether employers' choice of scheme will become more restricted as automatic enrolment gathers pace.

Employer Choice

11 Chapter 4 considers how the annual contribution limit and restrictions on transfers might impact employers' choice. Employers will consider a range of factors in deciding which scheme or schemes to use for automatic enrolment. It also sets out how these considerations may differ for larger and smaller employers.

12 At this stage, with only the largest employers fully engaged in their response to automatic enrolment, there is limited detailed evidence of what is influencing employer choice.

13 This chapter sets out what we know about how larger employers are choosing to fulfil their automatic enrolment duties and explores whether the annual contribution limit and the transfer restrictions on NEST are working in a way that was not intended. In particular, it looks at whether the existence of these constraints:

- lead to additional complexity or cost for employers, especially many small and medium employers
- restrict employers' choice of pension provision in a way that could lead to outcomes for their workers which are not the most suitable for them, and
- are likely to make these problems more or less acute as the reforms are implemented and smaller employers are required to automatically enrol their workers.

14 It also seeks evidence on whether the perceived complexity of the annual contribution limit and the restrictions on transfers is influencing employers' choice of scheme even where their workforce is in NEST's target market.

Consumer Interests

15 Chapter 5 examines whether the existence of the annual contribution limit and the transfer restrictions is likely to have a detrimental effect on individuals making provision for their retirement.

16 It is critical to the success of the reforms that employers' choice of scheme or schemes suits the characteristics of their workforce. This will ensure their workers are enrolled in a suitable pension at an appropriate level of charges and encourage persistency of saving.

17 We consider the optimal balance between employer choice and consumer interests. In particular, we consider how important it is to establish whether this

balance is likely to shift as the implementation of automatic enrolment progresses with smaller employers.

Possible Alternative Approaches

18 The Government will reflect on the evidence and views submitted in response to this call for evidence before deciding whether any action is required.

19 To stimulate debate, Chapter 6 outlines a range of possible alternative approaches which could address the concerns set out in this paper and raised by the Select Committee. We invite discussion and feedback on these proposals as well as suggestions for any other changes in the rules that might help employers and individuals in particular circumstances.

Next Steps

20 Chapter 7 sets out the consultation process and summarises the consultation questions. The consultation closes on **28 January 2013**. We will follow this call for evidence with a government response in spring 2013.

1 Introduction

1 People are living longer and many are not saving enough to deliver the pension income they are likely to want or expect in retirement. Automatic enrolment into workplace pensions is being introduced to encourage and enable people to save more. The largest employers are already starting to automatically enrol eligible workers into a workplace pension and to make minimum contributions. Once the reforms are rolled out, we expect eleven million people to have been automatically enrolled by their employers and six to nine million people to save into a workplace pension for the first time or to save more than before[3]. This will transform the UK's long-term savings culture.

2 The National Employment Savings Trust (NEST) is one pension scheme employers can choose to meet their automatic enrolment duties and, as the only scheme obliged to be available to all employers who wish to use it for automatic enrolment, has a key role in making automatic enrolment a success.

3 Between July 2011 and January 2012, the Work and Pensions Select Committee conducted an inquiry into automatic enrolment in workplace pensions and the National Employment Savings Trust. The inquiry examined the implementation of the reforms to ensure that they would be delivered effectively and in the best interests of workers and employers. It published its final report on 15 March 2012[4].

4 A key area the Committee examined was the role and impact of NEST, including its potential market share and the likely impact of two of the statutory constraints on NEST: the annual contributions limit and restrictions on transfers into and out of the scheme. While the Committee understood the policy intent, they received evidence indicating that these particular constraints might have unintended consequences and proposed that they should be lifted.

> "By lifting these two key restrictions placed on NEST, the Government would remove barriers that might currently prevent employers from choosing NEST as their pension scheme, as well as making it easier for employees to bring together the other small pension pots they are likely to have. This will help reduce multiple administrative charges that many people pay and help them understand the total retirement savings they will have built up."
>
> *Dame Anne Begg MP, the Chair of the Work and Pensions Select Committee*

[3] Workplace pension reform: digest of key analysis, July 2012. DWP - See http://statistics.dwp.gov.uk/asd/asd1/adhoc_analysis/2012/wpr_digest_0712.pdf

[4] Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12.

5 The Committee concluded that the:

- annual contribution limit would result in severe complexity for businesses, as it would mean that employers with a combination of low and higher paid workers could not use NEST as their single pension scheme
- restrictions on transfers were a disincentive and additional cost for employers who would like to operate a single occupational pension scheme, and
- restrictions on individuals transferring pension funds into and out of NEST would disadvantage individuals who would like to consolidate separate pension pots.

6 Overall, the Committee concluded that these two constraints may prevent NEST from addressing the market failure it was designed to address and recommended that, if State aid rules permit[5], the Government should remove these constraints as a matter of urgency.

> "NEST was set up to address a market failure in the pensions industry which meant that many employers and employees were unable to access low-cost, good quality pension provision.
>
> However, the restrictions make it impossible for NEST to meet the needs of all employers and their employees who might want to use it. Unless the restrictions are removed, many employers will still not be able to access its low-cost pension scheme, and many employees for whom it was intended will not be reached."
>
> *Dame Anne Begg MP, the Chair of the Work and Pensions Select Committee*

7 The Government welcomes the Select Committee's focus on this issue and is keen to ensure that any barriers, or perceived barriers, to employers having access to a low-cost, high quality scheme are swiftly responded to. However, evidence that the annual contribution limit and the restrictions on transfers are acting as a barrier to employers choosing NEST is not conclusive and the Government is conscious that these particular constraints on NEST are intended to play a role in ensuring the scheme remains focused on its target market and complements existing good quality pension provision.

8 This call for evidence therefore seeks to inform the Government's thinking on the impact of the annual contribution limit and the restrictions on transfers and invites views and evidence from employers, pension providers, individuals and their representative groups on:

[5] State aid N158/2009 – United Kingdom, Establishment of the National Employment Savings Trust – NEST http://ec.europa.eu/eu_law/state_aids/comp-2009/n158-09.pdf

- how the pension market is evolving in response to the introduction of automatic enrolment and whether and how changes in the reach or cost of commercial provision are pertinent to the Government's consideration of the policy framework for NEST
- how employers are choosing to fulfil their automatic enrolment duties and, in particular, whether the existence of these two NEST constraints can (i) lead to additional complexity or cost for employers in responding to automatic enrolment (ii) restrict employers' choice of pension provision in a way that could lead to outcomes for their workers which are not the most suitable for them and (iii) whether such problems are likely to become more or less acute as the reforms are implemented and smaller employers are required to automatically enrol their workers, and
- a range of possible alternative approaches to addressing the concerns raised by the Committee.

2 Policy Background

The Pensions Commission

1 In 2005, the Pensions Commission proposed a package of reforms to both state and non-state pension provision[6]. It concluded that changes to the state pensions system would not be sufficient to provide an adequate pension income for individuals in the future and that increased private saving would be needed to avoid increases in pensioner poverty or unsustainable increases in taxation.

2 The Commission identified two main barriers to pension saving:

- demand side problems with barriers preventing individuals making rational savings decisions, including inertia, risk aversion and a lack of confidence in pension saving products, and
- a supply gap in the pensions market for those working for employers who were not well served by the existing pensions market, in particular low to moderate earners, those working for smaller firms, and employers with high staff turnover.

3 The Pensions Act 2008 introduced reforms to tackle these barriers:

- a new duty on employers to automatically enrol all eligible workers into a workplace pension, intended to overcome barriers to saving by harnessing inertia. Rather than having to decide to save in a workplace pension, a worker has to make an active decision not to save. The incentive to save is reinforced by a mandatory minimum employer contribution[7] and tax relief, and
- a new pension scheme – now known as the National Employment Savings Trust (NEST) – established in 2010 to underpin automatic enrolment by providing a simple, low-cost pension scheme for any employer who wants to use the scheme to fulfil the new employer duties, ensuring that low-cost pension provision is available for all eligible workers.

4 NEST is subject to the same legal requirements as other trust-based money purchase arrangements but its design - to resolve a supply side market failure and allow those pre-existing areas of the market that were functioning well to not suffer detriment - also imposed a unique set of constraints on the scheme:

[6] Pensions Commission, 2005, *A New Pension Settlement for the Twenty-First Century The Second Report of the Pensions Commission* (ISBN 0 11 703602 1)
[7] Workers earning £8,105 a year (2012/13) or more with a minimum employer contribution to the pension of 3% on a band of earnings (5,564 to £42,475 in 2012/13) and a minimum total contribution (including tax relief) of 8%

- It must accept all individuals automatically enrolled into it, even if the charge income derived from the individual does not cover the cost of their account - expressed through the public service obligation
- It must offer good value, with no price differential between members at a charge level comparable to those available to high earners and those working for large employers – a low-cost objective
- It cannot offer other products – ensuring simplicity, and
- It must target a group who commercial providers found it difficult to serve profitably - to provide a focus on this group two statutory constraints were placed on NEST, an annual contribution limit[8] and restrictions on transfers into and out of the scheme.

5 While NEST's eventual scale will allow it to operate under all these constraints and deliver low charges, it faces a much greater than normal funding requirement, one that no commercial lender would consider. NEST is therefore being funded by a loan from Government until it can be self-financing, with an estimated repayment period of at least 20 years.

The Public Service Obligation (PSO)

6 NEST's PSO is the response to the supply side market failure, requiring NEST to provide a workplace pension to any employer who wishes to use it to meet their employer duties and any worker enrolled by that employer with no price differential between members choosing the core service. NEST was intended to complement, rather than replace existing good quality pension provision, by targeting a group who commercial providers found it difficult to serve profitably, including:

- low to moderate earners
- smaller employers, and
- employers with a high labour market churn.

7 The nature of this target group means that membership of a workplace scheme is more likely to be low and scheme members are likely to be less able to make large pension contributions and less likely to save for a prolonged period due to uneven employment patterns[9]. This makes it difficult for pension providers to cover the upfront costs. As a result, providers tended to actively target those with higher earnings or working for large employers, with providers less likely to supply a workplace pension for the target group or only able to do so with comparatively high member charges. This effect was compounded by inefficient competition in this segment of the market and the fact that those on moderate to

[8] In 2012 earnings terms, the annual contribution limit is £4,400
[9] The Financial Services Authority, *Survey of the Persistency of Life and Pensions Policies, 2007;* available online at www.fsa.gov.uk/pubs/other/Persistency_2007.pdf

low incomes typically have a poor understanding of pensions and therefore do not exert effective pressure on providers to reduce costs or improve quality[10].

8 The PSO enables both employers and consumers in NEST's target market to have access to the equivalent low-cost, well-managed provision as higher earners and those who already have a workplace pension.

Charging Structure

9 NEST is responsible for setting the charge levels for the scheme, but the NEST Order 2010[11] provides that the Secretary of State has responsibility for determining the method of calculating how to make deductions.

10 NEST's charging structure was set following a public consultation[12] and research which evaluated the target group's responses to a range of possible charging structures. The impact of different charge structures on individuals was a key part of the evaluation process to ensure that NEST's charging structure will give more people access to retirement savings at the same low charges that higher earners and those in large workplace pension schemes enjoy.

Single Product

11 To ensure that the scheme is simple and straightforward, NEST Corporation's only function is to act as a trustee of a scheme established under section 67 of the Pensions Act 2008. NEST is unable to vary its services or offer other complimentary products[13] (for example life insurance), and access to NEST is restricted as membership can only be created through an automatic enrolment event[14].

The Annual Contribution Limit and Restrictions on Transfers

12 In June 2007, following the White Paper "Personal accounts: a new way to save"[15], the Government set out proposals[16] for taking forward two specific constraints to focus NEST on its target group, the annual contribution limit and restrictions on transfers into and out of the scheme. These constraints were seen as important elements in building a consensus behind the proposed pension reforms. It was envisaged that:

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[10] The Sandler Review of Medium and Long-term Retail Investment, July 2002, found that competitive forces did not always work to deliver value and charges for near-identical products could vary widely.
[11] NEST Order 2010 (SI 2010/917) Article 27
[12] http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/general-info-charging-consultation,PDF.pdf

[13] The Pensions Act 2008 s.76
[14] The National Employment Savings Trust Order 2010 – SI 2010/917 - Article 19
[15] Personal Accounts: a new way to save – December 2006
[16] Personal Accounts: a new way to save, Summary of responses to the consultation – June 2007

- an annual limit on NEST contributions of £4,400 (in 2012 earnings terms) would focus NEST on the target market of low to moderate earners, and promote market stability by minimising the impact on existing good quality schemes and products during automatic enrolment implementation
- restricting transfers into and out of NEST would also promote market stability and would bring administrative simplicity for the scheme; encourage persistency of saving; and enable lower charges for the benefit of all scheme members. However, the White Paper recognised that, over time and as the target market evolved, the case for allowing transfers would grow, if only to provide parity with other defined contribution occupational schemes.

13 The subsequent legislative provisions were implemented in the Pensions Act 2008[17] and the NEST Order 2010[18], and the Act requires the effect of the annual contribution limit and restrictions on transfers to be reviewed in 2017[19].

14 In setting the annual contribution limit and restrictions on transfers, a key policy concern was that NEST's presence in the market would not encourage employers to abandon their existing good quality schemes and move their workers to NEST. This was to avoid 'levelling down' - keeping NEST focused on serving the needs of a defined target market and mitigating the risk of consumer detriment.

15 Assuming a minimum contribution rate of 8% and contributions paid on earnings from the lower limit of the qualifying earnings band of £5,564, earnings in excess of around £60,000 per year are required to breach the annual contribution limit.

Table 2.1: Earnings distribution for all private sector employees

	Gross annual earnings					
Firm size	**£0 - £14,999**	**£15,000 - £29,999**	**£30,000 - £44,999**	**£45,000 - £60,000**	**£60,000 +**	**Number of employees**
1 to 4	56%	34%	6%	2%	2%	739,671
5 to 49	32%	44%	15%	4%	4%	3,299,391
50 to 249	23%	45%	20%	6%	7%	2,563,401
250+	26%	39%	20%	8%	8%	8,373,664
Total	28%	41%	18%	6%	6%	14,976,128

Source: DWP analysis of ASHE, 2011

16 State aid rules apply to NEST since it operates in a market and is therefore an undertaking. The approval of the current State aid to NEST, delivered via the Government's loan, is a consequence of its public service obligation. The

[17] Pensions Act 2008 – Chapter 5
[18] The National Employment Savings Trust Order 2010 – SI 2010/917
[19] Pensions Act 2008 s.74

annual contribution limit and restrictions on transfers – whilst not integral to the case – were cited in the original approved case as underpinning how Government sought to minimise any distortion in the market. We anticipate that the Commission will want to re-assure themselves that any change to the policy framework for NEST is consistent with the provision of State aid. However, the annual contribution limit and restrictions on transfers do not directly lead to the additional costs upon which the approved case is based. Additionally, it has always been the case that the legislation provides for these two constraints to be reviewed in 2017 potentially leading to their removal from that point.

Designing NEST

17 The existence of all the constraints focussed NEST on low to moderate earners and smaller employers as the scheme design developed. NEST researched the characteristics of the target group and reflected these findings in the development of its product, including in the way that it has designed its investment approach and the way it communicates with its members. For example:

- NEST's investment approach[20] is based on research into the attitudes and behaviour of savers. NEST expects most of its members to default into the NEST Retirement Date Fund that matches their expected retirement date There is a selection of other funds, for example higher risk, ethical and sharia funds to reflect the diversity of expected membership, but these are limited to avoid confusion or the conclusion that an investment decision needs to be made
- NEST carried out research to understand how best to communicate with its target market, testing and refining its approach through engagement with individuals and developing a scheme vocabulary and approach to communications that is simple, free of jargon, and explains concepts in a manner that resonates with the target market
- NEST has also developed an approach to securing a retirement income[21] for its members that takes account of the particular challenges that the target group might face when securing a retirement income. NEST has ensured that its solution can offer members with pots of more than £1,500 (lower than the industry norm) a way to purchase a retirement income.

The Making Automatic Enrolment Work Review

18 In 2010, the Coalition Government commissioned an independent review to look at how best to support the implementation of automatic enrolment into workplace

[20] http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/investment-consultation-response,PDF.pdf
[21] http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/general-info-securing-a-retirement-income-consultation,PDF.pdf

pensions. The *Making Automatic Enrolment Work* review[22] confirmed that the supply gap persisted as the introduction of automatic enrolment approached and confirmed that NEST remained necessary to support the successful implementation of automatic enrolment.

19 It also re-considered the appropriateness of the annual contribution limit and the restrictions on transfers and made two specific recommendations:

- legislation should be brought forward immediately, making it clear that NEST's contribution limit would be removed in 2017 as this created complexity for employers who might wish to choose NEST, added cost and complexity to the development of the scheme, and sent a misleading message about what constitutes an adequate level of pension saving that people need to make.
- Government and regulators should consider how to ensure that it is more straightforward for people to move their pension pot with them as they move employer, so that by the time of the 2017 review the more general issue of pension transfers has been addressed and all restrictions on NEST being able to receive transfers in and make transfers out should be removed.

Issues for Consideration

20 The remainder of this document explores issues pertinent to whether the annual contribution limit and the restrictions on transfers on NEST work in the way that they were intended, and whether or not there is a case for change:

- Chapter 3 looks at how the pension market has evolved in response to the introduction of automatic enrolment
- Chapters 4 and 5 look at how employers have chosen to fulfil their automatic duties and, in particular, whether the existence of the annual contribution limit and transfer restrictions on NEST can (i) lead to additional complexity or cost for employers in responding to automatic enrolment and (ii) restrict employers' choice of pension provision in a way that could lead to outcomes for their workers which may not be in their interests
- Chapter 6 outlines a range of possible alternative approaches for discussion.

[22] http://www.dwp.gov.uk/docs/cp-oct10-full-document.pdf

3 The Supply Side Landscape

NEST's Role

1 DWP research with pension providers in 2011[23] indicates that they generally fall into two categories: high-end providers that target larger employers or those with medium to high average salary levels typically offering a wide range of pension products and investment options; and, mass market providers that cater for a wider range of employers in terms of size and salary. This potentially includes smaller employers and lower salaried employees, but such business is often less profitable for the provider, due to lower membership levels and lower average contributions[24].

2 In the research, pension providers typically predicted that NEST would have a significant impact on the pensions market in terms of setting standards against which other products would be compared. However, pension providers did not predict that NEST would have a detrimental impact on their own business, given that NEST's target market was largely not catered for by current providers.

3 The expectation was that large employers would generally have adequate access to pension provision in the pension market to fulfil their automatic enrolment duties and that such employers would use a mixture of pension provision to meet their duties. Qualitative research[25] indicates that some providers will work alongside NEST to meet employer needs, especially in areas where workplace pensions have traditionally not been offered or only offered with restricted access, for example NEST might be offered as an entry or foundation scheme to serve particular elements of an employers' workforce (lower earners and/or high churn segments), on top of which an existing commercial provider might offer further benefits. NEST is already working with some providers where this arrangement is suitable to meet the needs of employers.

4 The pension industry has, however, traditionally found it more difficult to profitably serve low to moderate earners and smaller employers. These groups constitute the core of NEST's target market with the expectation that an increasing proportion of employers will use NEST as smaller employers are brought incrementally into the reforms.

[23] Wood, Young, Wintersgill, Crowther (2011) *'Likely industry responses to the workplace pension reforms'*, DWP research report 753
[24] Ibid
[25] Ibid

Impact of NEST

5 In their evidence to the Work and Pensions Select Committee, representatives of the pensions industry acknowledged that the existence of NEST in the market has had a positive effect on the private pensions market, encouraging simplicity and improved member engagement and communication.

> "…we have to give credit to what NEST has set out to do, because it has set out to use the opportunity … to redesign the way they engage with and talk with their customers. In terms of the language that is used and the simplicity in the way facts are presented, in all aspects of what they are doing."
>
> *ABI*
>
> "Ever since NEST's inception they have led the way in forming a new lexicon and new ways of creating very clear and simple communications to customers that the rest of the industry are avidly following."
>
> *Legal & General*
>
> *Source: Work and Pensions Select Committee - Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12*

6 NEST was also cited as one factor in maintaining downward pressure on member charges. Charges have fallen significantly since the introduction of Stakeholder Charge Cap in 2001 and recent evidence suggests the downward trend is continuing in the approach to automatic enrolment[26].

> "[NEST] is setting standards that will force the market to normalise at a level that I think we should be able to demonstrate is good value for money for the services provided."
>
> *ABI*
>
> *Source: Work and Pensions Select Committee - Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12*

Response of the Market to Automatic Enrolment

7 Commercial providers have responded positively to automatic enrolment:

- new products and technologies have been introduced to support employers in responding to automatic enrolment

[26] Wood, Young, Wintersgill, Crowther (2011) *'Likely industry responses to the workplace pension reforms'*, DWP research report 753

- new providers have entered the market and existing providers have revisited their market strategies, with some observers suggesting an increasing move amongst providers to build scale as a means of reducing the cost of supply
- early evidence from the very largest employers suggests that commercial providers may be more willing to provide a low-cost pension to employers with a large number of relatively low paid and high turnover workers than earlier modelling had suggested, and
- both new entrants to the market and some existing providers have indicated a willingness to supply a workplace pension to a more diverse portfolio of employers, including small and micro employers.

"We are open for business for any size employer, big or small. Our only concern ultimately is not size or number of employees; it is really how well their records are kept."

NOW:Pensions

"…very small businesses will default to NEST or possibly to ATP…who will be very focused on that small-business market."

CBI

"The market is evolving in a Darwinian sense. The providers that have not achieved scale are exiting the market."

Legal & General

Source: Work and Pensions Select Committee - Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12

8 The extent to which commercial providers are able, and willing, to supply a suitable low-cost workplace pension product to a diverse range of employers is central to our consideration of whether the NEST annual contribution limit and transfer restrictions are likely to have a detrimental effect on individuals making provision for their retirement:

- where an employer does not choose NEST but is able to access suitable, low-cost alternative provision, issues of consumer detriment will not arise
- however, if these two constraints led to an employer rejecting NEST and a suitable, low-cost alternative scheme was not available, then detriment may arise as a result of employers choosing a less suitable or a more expensive product for their workers than was necessary.

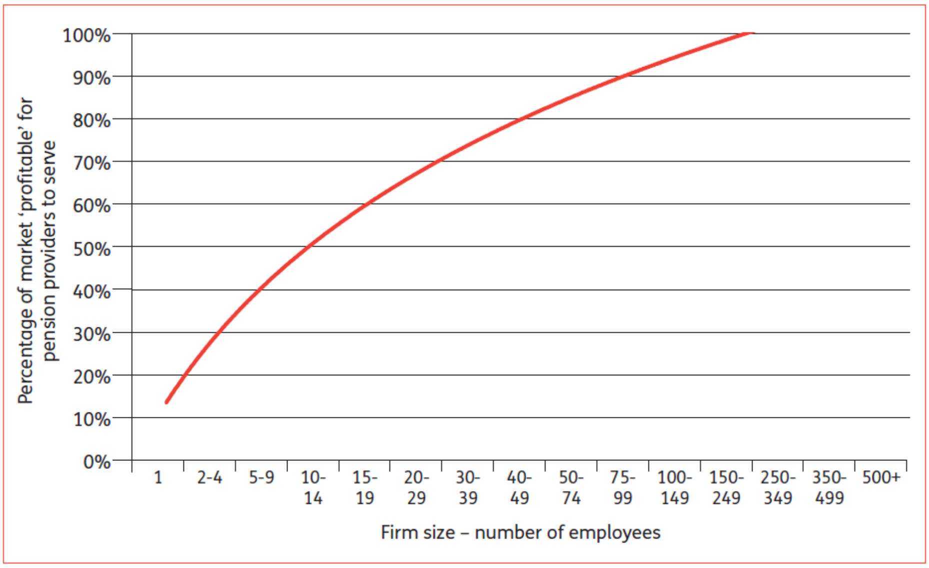
9 This chapter sets out what we know about the factors that affect a pension provider ability to supply a suitable, low-cost workplace pension to different types of employer; chapter 4 then goes on to consider how the annual contribution limit and the transfer restrictions might impact employers' choice.

Factors Affecting Supply Side Decisions

10 The *Making Automatic Enrolment Work* review highlighted the importance of firm size, average salaries and staff turnover as critical factors in pension market profitability and, therefore, the ability of the market to supply a simple, low-cost product to particular classes of employer.

11 Chart 3.1[27] illustrates that the number of members matters to providers; higher volumes not only increase total contributions but also spread the fixed costs of set up over more members. This means employer size can be a proxy for membership, and potential profitability.

Chart 3.1 : Employer size and profitability, assuming charges at the Stakeholder Charge Cap and average take up of 70 per cent



12 Evidence[28] also suggests there is a strong correlation between average pay and profitablity. Employers who pay an average salary below £16,000 are very rarely profitable to pension providers and only around half of those paying an average salary between £16,000 and £20,000 are profitable. This can reinforce the impact of employer size as a larger proportion of employees working for micro firms than those working for larger firms earn less than £16k[29].

[27] Johnson, Yeandle, Boulding (October 2010) *Making automatic enrolment work, A review for the Department for Work and Pensions*, Source Department for Work and Pensions modelling
[28] Ibid
[29] DWP analysis of Annual Survey of Hours and Earnings, http://www.ons.gov.uk/ons/rel/ashe/annual-survey-of-hours-and-earnings/ashe-results-2011/ashe-statistical-bulletin-2011.html#tab-background-notes

> "If a particularly small employer with a particularly low payroll comes to us and we find that we cannot price competitively … we decline to tender to that business. That is precisely why NEST was built."
>
> *Legal & General*
>
> *Source: Work and Pensions Select Committee - Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12*

13 Evidence[30] also indicates that profitability could be impacted by member persistency. Almost all employers with the lowest job churn are profitable, compared with less than ten per cent of employers with the highest job churn, and small and micro employers tend to have higher staff turnover than larger employers[31].

> "One of the key factors … is around how long those individuals are going to stay with the employer….if half the population of employees are going to move after three or four months, then in that situation it is probably much more sensible for those individuals to go to NEST..."
>
> *Friends Life*
>
> *Source: Work and Pensions Select Committee - Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12*

14 Where providers are willing to make provision for smaller employers, DWP research '*Pension Landscape and Charging'* [32] suggests that charges are also likely to vary by employer size, employee salary level, employer contribution level, and persistency of saving.

Table 3.1: Average AMC and scheme size[33]

	Scheme size (number of members)			
	12-99	**100-999**	**1,000+**	**All****
Trust based schemes	0.82%	0.66%	0.48%	0.71%
Contract based schemes	(low base*)	0.82%	0.48%	0.95%

Base: All trust-based schemes where members pay charges as % of fund (164), 12-99(34), 100-999 (69), 1,000+ (53); all contract-based schemes where members pay charges as % of fund (141), 12-99(27), 100-999 (53), 1,000+ (47). Research carried out September – November 2011
** low base= insufficient sample size in this category for further analysis*
*** calculated using full employer sample*

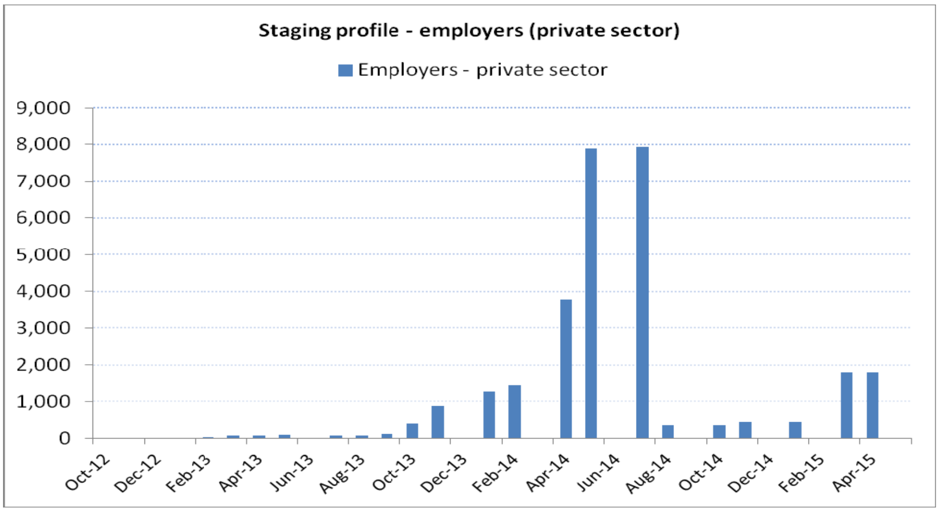
[30] Johnson, Yeandle, Boulding (October 2010) *Making automatic enrolment work, A review for the Department for Work and Pensions*, Source Department for Work and Pensions modelling
[31] Source: Small and Medium Enterprise Statistics, United Kingdom 2008, Department for Business, Innovation and Skills
[32] Wood. A, Wintersgill.D, Baker.N, (2012) *Pension landscape and charging: quantitative and qualitative research with employers and pension providers*; DWP Research Report 804

[33] Source: Pension landscape and charging: quantitative and qualitative research with employers and pension providers - 2011

Capacity in the Pensions Industry

15 Another factor that may impact on the extent of employer choice is the available capacity of the pension industry to meet demand as the number of employers seeking to meet their automatic enrolment duties ramps up. Automatic enrolment will create an unprecedented level of new business with peaks of industry capacity required at specific and limited periods during the implementation period, with significant peaks in the number of employers scheduled to implement automatic enrolment between January 2014 and July 2014.

Chart 3.2[34] : Staging profile – employers (private sector)



16 During this period, around 22,000 private sector employers with workforces ranging in size from 499 down as low as 61 employees and employing in total around 2.1 million eligible workers will be required to meet their automatic enrolment duties.

17 The ability of the industry to meet such peaks of demand is unclear, and although some providers have indicated a willingness to supply workplace provision at scale and to the smallest employers at a charge level not dissimilar to NEST's, they are not obliged to do, so there is no guarantee of how much capacity they can or will choose to supply. This may be exacerbated by the fact that, as the size of the employers decrease through the implementation period, there may be fewer pension suppliers willing to support employers in implementing their response to the duties.

18 Restricted choice in the pension market during this period may exacerbate the problems being raised about the impact of the annual contribution limit and the transfer restrictions on NEST. This could be because employers are deterred

34 Source: DWP modelling

from using NEST and are less likely to find a suitable alternative product. If this does occur, it is likely to be most acute from 2014 onwards.

Recent Policy Developments

19 The Government has been considering some of the broader challenges that come with more widespread pension saving. In particular, automatic enrolment will result in a significant increase in the number of dormant occupational pension pots as more people save whilst moving jobs during their working life. The Government is concerned that as automatic enrolment rolls out, a proliferation of small dormant pots may:

- be detrimental to an individual's ability to manage their savings and their eventual retirement income, and
- lead to a significant administrative overhead on pension providers, leading to upward pressure on costs passed on as charges for pension scheme members.

20 We estimate that without change, there will be around 50 million dormant workplace defined contribution pension pots within the system by 2050, and that in excess of 12 million of these will be less than £2,000 (in 2012 earnings terms)[35].

21 In July 2012, the "*Government response to the consultation: Improving transfers and dealing with small pension pots*" (Cm8402) set out that the direction of travel would be to remove short service refunds and provide for a system where small pots would automatically transfer to the new employer's pension scheme on job changes. The assumption has been that NEST would be involved in automatic transfers, and this was the basis of the Government's analysis in the response.

22 The current restrictions on transfers would exclude NEST from a new system of automated transfers. Given NEST's scale, this would mean that the number of small pots that could be consolidated, and the financial benefits that would accrue from consolidation, would be significantly reduced. It would also mean that NEST members would not be able to benefit from automatic transfers as part of any broader industry wide solution.

Consultation Questions

Q1. **What evidence is there that the current downward pressure on charges is sustainable as smaller, less profitable employers start to meet their automatic enrolment duties? Is this relevant in considering the impact of the annual contribution limit and the transfer restrictions on NEST?**

[35] Government response to the consultation: Improving transfers and dealing with small pension pots (Cm8402)

Q2. **What evidence is there that the current pension industry has the capacity to serve the peaks in employer demand and put solutions in place to meet the demand for good quality, low-cost schemes? Is this relevant in considering the impact of the annual contribution limit and the transfer restrictions on NEST?**

Q3. **Do you agree that NEST should be able to fully participate in any automatic transfer solution?**

4 Employer Choice

1 Employers will consider a range of factors in deciding which scheme or schemes to use for automatic enrolment. It is critical to the success of the reforms that employers' choice of scheme or schemes suits the characteristics of their workforce. This will ensure their workers are enrolled in a suitable pension at an appropriate level of charges and encourage persistency of saving.

2 The annual contribution limit and the transfer restrictions are two of the constraints intended to focus NEST on its target market. Restricting the level of contributions an individual can make in a given year makes NEST less suitable for more highly paid individuals. Restricting transfers into the scheme means NEST cannot be used to consolidate existing pension savings.

3 Evidence provided to the Work and Pensions Select Committee suggested that these two constraints on NEST could influence employers' decisions over their automatic enrolment scheme choice in ways that were not anticipated. This evidence suggested that these two constraints are seen by employers as an additional layer of complexity and could lead some employers to reject NEST at an early stage before fully considering its appropriateness for their workforce.

4 At this stage, with only the largest employers fully engaged in their response to automatic enrolment, there is limited detailed evidence of what is impacting employer choice. Recent DWP discussions with Employee Benefit Consultants does, however, support the view that the real and perceived complexity of these two constraints is inhibiting employer choice even where their workforce is in NEST's target market.

5 The extent to which these complexities bite on an employer's decision will depend on a variety of factors:

- the extent to which an employer is confident and knowledgeable about workplace pension provision or has access to support or advice in determining the best provision
- the size, earnings distribution and turnover rates of the workforce, which will determine both the extent to which the annual contribution limit and restrictions on transfers potentially create an obstacle to using NEST, and the likelihood that a suitable commercial alternative is available for the whole workforce or specific segments of the workforce
- the trade-off in the employers' judgement between avoiding additional administrative complexity and cost, and segmenting pension provision so it is tailored to needs and circumstances of specific segments of the workforce, and
- other perceived barriers to using NEST including:
  - NEST is a new scheme, and employers are likely to view NEST as a risk
  - other schemes now compare more favourably with NEST on charges

- employers perceive other providers will offer more support than NEST in implementing a solution for automatic enrolment by supplying employers with the software required to link their scheme with payroll for example, or providing other administrative support.

6 Different sized employers will, therefore, have different experiences in understanding NEST, determining whether NEST is suitable for their workforce and working through the practical implications. Larger employers are more likely to have a wider earnings distribution or legacy pension provision; they are also more likely to have expertise or access to advice; and they may be more willing to segment provision for different sections of their workforce. Smaller employers are likely to have narrower earnings distribution and are less likely to have legacy pension, but they are also less likely to have access to expertise or to see benefits in segmenting their smaller workforce.

Employer Preference for a Single Scheme Solution

7 The reforms anticipated that employers who already had pension provision for some segments of their workforce or who have a diverse workforce may use more than one scheme to fulfil their automatic enrolment duties, possibly including NEST as part of a package of pension provision. For example, an employer might use NEST for higher turnover or lower paid segments of the workforce, perhaps using NEST as a ‘feeder scheme’ with controlled access to an existing pension scheme.

8 Some stakeholders have suggested, however, that there is an emerging preference amongst employers for a single scheme solution to automatic enrolment and that NEST is being rejected as a single scheme solution, because, as the examples below show, a single scheme solution can be complex or impossible to achieve with NEST.

Illustrative Example 1

An employer's workforce has earnings between £8,500 and £50,000 but is largely lower paid, with relatively high turnover. The employer wants to introduce a straightforward workplace pension scheme with a total contribution rate of 9% of total earnings. Given the low average earnings and high turnover of his workforce, the employer considers that NEST offers the most suitable, best value solution for his workforce. Considering how to use NEST would first require the employer to understand how the contribution limit applies and assess whether anyone in his workforce is likely to breach the limit. If they are the employer then has a number of options:

- To reduce the generosity of the scheme for all employees (by reducing contributions or restricting pension contributions to a band of earnings) and keeping the interaction of earnings and the contribution limit under review
- To reduce the generosity of provision for higher earners only
- To use NEST for lower paid workers and find alternative provision for higher earners
- To choose a single scheme solution, other than NEST.

Illustrative Example 2

An employer has a relatively low earning and high turnover workforce. Prior to the introduction of automatic enrolment, a workplace pension was provided but access was restricted to workers who remained with the company for two years, leading to a minority of workers having an existing pension pot. Given the size and profile of his workforce, the employer considers that NEST offers the most suitable solution for his total workforce. However, the employer is unable to transfer the legacy pension pots into NEST and must choose to:

- Use NEST for the entire workforce, but maintain separate provision for previously accumulated savings
- Use NEST for workers without previous savings and find alternative provision for workers with existing savings
- Use a single scheme solution, other than NEST.

9 The Select Committee confirmed this view and suggested that it was likely the effect would grow as smaller employers were brought into automatic enrolment, as for many of them it would be even more important to be able to use a single scheme for all employees[36].

[36] Work & Pensions Select Committee - Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12 page 46

10 DWP research also suggested that an employer's appetite for using multiple schemes has reduced as they engaged with the detail of the reforms. Research in 2009[37] showed that 18% of employers with 5000+ employees would use multiple schemes for their existing members, compared to only 5% in comparable research in 2011[38] (due to the implementation profile for the reforms only the largest employers would have engaged in the detail of the reforms at the time of this research).

11 However, since the larger employers have gained a better understanding of the reforms there has been some early indication from Employee Benefit Consultants that there may be a more widespread appetite amongst these employers for using multiple schemes. This is particularly the case for employers with a diverse workforce, who do not wish to place all their employees in the same scheme.

12 It is, however, still unknown the extent to which the smaller employers will also want to use a multiple scheme solution. If they do prefer to choose a single solution their choice may be restricted to using NEST[39] and managing the difficulties the annual contribution limit and the transfer restrictions may pose, or seeking an alternative provider who, depending on the size and characteristics of their workforce, may or may not offer a scheme as suitable or as good value to members as NEST.

> "It is probably unlikely we would [offer pension provision] for smaller employers, because in those situations we think those employers would probably want to use just one provider for their whole scheme; it would not be worth their while having two different providers for an employer of, say, three or four employees. It would be just too complicated."
>
> *Friends Life*
>
> Consumer Focus highlighted that employers with both lower-paid and higher-earning senior staff could be put off using NEST as they would need a separate scheme for their high paid workers.
>
> The TUC expressed concerned that the contribution limit would put an unnecessary burden on employers, who would have to offer more than one scheme for a workforce of varying salaries.
>
> "generally employers – especially smaller ones – would like to have one provider… and the existence of the cap creates some difficulty for [employers] in deciding how to respond to the new duties"
>
> *NEST*
>
> *Source: Work and Pensions Select Committee - Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12*

[37] Bewley H and Forth J (2010) Employers' attitudes and likely reactions to the workplace pensions reforms 2009, DWP Research Report No. 683

[38] Forth, J, Stokes, L, Fitzpatrick, A and Grant, C (2012) *Employers' Pension Provision Survey 2011* Research Report No. 802

[39] Ibid

Consolidation

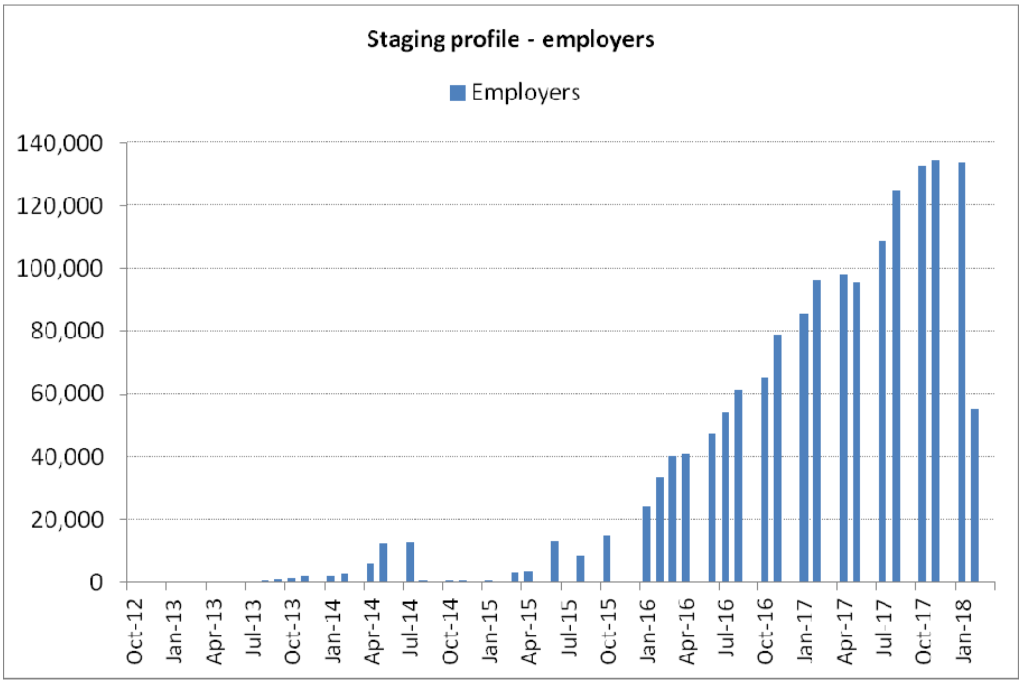
13 As large and mid-corporate employers make decisions about how they will meet their employer duties, some may be reviewing their benefits package and taking the opportunity to consolidate their pension arrangements. This decision point gives employers the chance to rationalise their pension arrangements which may, perhaps through historic acquisitions or structural changes, have become fragmented.

14 The Select Committee suggested that the restrictions on transfers will be disruptive both for individuals who would like to consolidate separate pension pots into NEST and for employers who would like to consolidate their occupational pension schemes. Depending on the make-up of an employers' workforce, NEST may be an appropriate scheme to consider for future pension provision. However, an employer looking to consolidate would be unable to do so in NEST.

Impact of the Implementation Approach

15 Automatic enrolment is being implemented by size of employer, with the largest employers going first. As the chart below indicates, the vast majority of employers in the UK are small employers with over 99% of firms employing less than 250 workers and over 96% less than 50 workers.

Chart 4.1 : Staging profile - employers



Source: The Pensions Regulator[40]

[40] Automatic Enrolment: Staging profile and forecast volumes - http://www.thepensionsregulator.gov.uk/docs/automatic-enrolment-staging-profile-and-forecast-volumes.pdf.

16 Smaller employer’s experience is likely to differ from their larger counterparts:

- The smaller the employer, the less likely they are to have in-house expertise or access to advice. This may impact on their propensity to reject NEST simply as a result of the perceived complexity of the annual contribution limit and/or the transfer restrictions
- The smaller the employer, the more likely they are to seek a single scheme solution
- Smaller employers are more likely to have narrower earnings distributions and less likely to have existing pension arrangements. This means the contribution limit and the transfer restrictions are less likely to have a real world impact, but the employer is less likely to be equipped to reach this conclusion or resolve any issues relating to the annual contribution limit and the restrictions on transfers that do arise
- Smaller employers are less likely to have a choice of low-cost pension provision as pension providers do not typically seek their business, or may decline to supply, or may only be able to supply at comparatively high member charges. This may be exacerbated by the scale of implementation with over 1.5 million employers being brought into the reforms in the period from April 2014 with only a limited element of the supply market willing or able to respond to this size of employer, and
- Smaller employers are less likely to have in-house pensions or HR processing capacity, so ensuring the costs of scheme choice and set-up are kept to a minimum are particularly important for this group.

Consultation Questions

Q4. **What evidence is there that the annual contribution limit and the transfer restrictions placed on NEST are or will influence employers’ decision making?**

Q5. **Is there evidence of employers feeling unable to choose NEST for their workers due to the annual contribution limit and/or the transfer restrictions?**

Q6. **Is there evidence that employers (of any size) are prioritising or will prioritise a single scheme solution for automatic enrolment?**

Q7. **Is the existence of the annual contribution limit and/or the transfer restrictions on NEST adding to the cost to employers of responding to automatic enrolment?**

Q8. **Is there evidence that the impact of the annual contribution limit and/or the transfer restrictions on employer decisions is leading or will lead to sub-optimal pension outcomes for workers?**

Q9. **What factors should the Government take into account when considering the likely impact of the annual contribution limit and the transfer restrictions on employer choice as smaller employers are brought into the reforms?**

5 Consumer Interests

1 A number of commentators have raised concerns that the annual contribution limit and the restrictions on transfers may act against the interest of individuals.

> "It is wrong to think that members of NEST's target market will never wish to save more than the cap. They may receive some additional non-earned income such as a legacy that they may wish to put towards their pension. They may be at a stage in their life when they wish to give some priority to building up their pension and be prepared to reduce consumption to do so. The pension system should not discourage this."
>
> *TUC*
>
> "[We] see no reason why NEST could not accept small transfers in order to facilitate the amalgamation of small pots"
>
> *Friends Life*
>
> "[the contribution limit would] frustrate the overall objective of promoting adequate levels of retirement saving"
>
> *The Pensions Management Institute*
>
> "[if employers decided to avoid NEST as a result of the contribution limit, this could] expose many employees to the possibility that their money is deposited in funds that are not really suitable, thus losing a proportion of savings in higher fee charges"
>
> *Federation of Small Business*
>
> "[the contribution limit would result in] "less value for money to customers"
> *RSA*
>
> *Source: Work and Pensions Select Committee - Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12*

2 Ensuring the availability of a simple, low-cost workplace pension scheme for those employers and their workers, who previously had limited access to suitable provision, is the primary objective behind the establishment of NEST.

3 It is critical to the success of automatic enrolment that employer choice leads to individuals getting a good deal when saving for their retirement. That means that the workplace provision they are automatically enrolled into should be suitable for their savings needs and personal characteristics, and the charges they pay should offer good value for money.

4 Scheme choice for automatic enrolment rests with the employer and an employer's motivations for choosing a scheme do not necessarily align with those of the individual. Once an employer has selected a scheme, however, it is

not the employer but the scheme members who would suffer detriment if that choice proves not to be the most suitable for them.

5 Employers who perceive the annual contribution limit and/or the transfer restrictions on NEST as obstacles to choosing NEST may be making a rational choice from the employer's perspective, but the consequences for their workers are equally important.

6 It is also important to recognise that the annual contribution limit and the transfer restrictions were intended to protect consumer interests, both by minimising disruption to the pensions market as automatic enrolment is implemented and to mitigate the risk that employers with existing, good quality provision might use NEST to "level down" the generosity of their workplace scheme.

"…the base of consensus, [was] driven...by a real worry about levelling down of existing, more generous pension provision. That was the driver at the time."

NOW Pensions

"What we did not want to see was employers levelling down in contributions or shifting into NEST. Frankly, that would not be in the interests of scheme members who are in schemes with, generally speaking, higher contributions. What [my members] did not want to see was employers levelling down and going from contributions that have 11% or 12% going into them to something that had much poorer contributions."

NAPF

"For the minority of employers who contribute more than 3% at the moment, only about 10% of private sector employers contribute more than 3%, but they cover 50% of pension members, because it tends to be the larger employers. Those employers are the ones that potentially could level down.

Pensions Policy Institute

"[NEST's] impact, as the Johnson review acknowledged, is highly uncertain. The interests [the constraints are] protecting is generally everybody's. From the Government's perspective, it was certainly not in the Government's interest to set up a scheme that could potentially become a dominant or near monopoly provider in the private savings market. From a consumer perspective … I do not think that anyone would disagree that it is important to have a degree of competition and choice…[the constraints] protects choice, and consumer choice in particular……it is very difficult to argue that you should decide to do something before fully assessing the impact of such a dramatic policy shift."

Investment Managers Association

> "[the] restrictions make it difficult for NEST to compete in the marketplace in areas of high-earning individuals and individuals wanting to transfer money from existing pension schemes, which are areas already well catered for by the private sector....[they] also serve to keep NEST focussed in its key need, which is the small employer and the low-paid employee, who are not well serviced by the private sector. Were those restrictions lifted, I fear NEST would be distracted from its key need, where there is a real social purpose for it, and would wander off into other areas of the market."
>
> *Legal & General*
>
> *Source: Work and Pensions Select Committee - Automatic enrolment in workplace pensions and the National Employment Savings Trust – Eighth Report of Session 2010-12*

Consultation Questions

Q10. **How should the Government best protect consumer interests? Would a different policy response be appropriate for smaller employers?**

Q11. **Are there other aspects of consumer detriment relating to the annual contribution limit and/or the transfer restrictions on NEST that the Government should consider?**

6 Possible Alternative Approaches

1 The Government will reflect on the evidence and views submitted in response to this call for evidence before deciding whether any action is required. However, in this chapter, we set out a range of possible alternative approaches for discussion that might be adopted depending on what the emerging evidence tells us.

2 For each approach, we would like to know whether you think the approach is necessary and sufficient, and what the impact would be on individuals, employers, NEST and other pension providers.

3 These are not intended to be exhaustive and we invite proposals for alternative approaches or changes in the rules which could address the concerns that have been raised or to help employers and members in particular circumstances.

4 It should be noted that any proposal to remove or amend the annual contribution limit and/or the transfer restrictions would be subject to Parliamentary approval. This means there would be an inevitable time-lag before any proposal could be implemented.

Approach 1: Remove the annual contribution limit and the transfer restrictions altogether at the end of staging (February 2018)

5 This approach retains the annual contribution limit and the transfer restrictions until all current employers have met their duties. This would maintain the status quo, and prioritises this above the need to address the concerns outlined in this paper and raised by the Select Committee.

6 The Pensions Act 2008 requires the Secretary of State to appoint a person to review the annual contribution limit and the transfer restrictions in 2017. This was intended to allow for the need for these two constraints to be reviewed once the reforms had been rolled out to all employers (subsequent policy changes have extended this implementation period until 2018).

7 In October 2010, the *Making Automatic Enrolment Work* review concluded that the annual contribution limit and the transfer restrictions should be removed from the end of the staging period. The review's conclusions were widely welcomed by stakeholders.

8 This approach accepts the conclusions of the *Making Automatic Enrolment Work* review. However, such an approach:

- would prevent NEST participating in any system of automatic transfers to tackle the proliferation of small pots that will follow the introduction of automatic enrolment until 2018 at the earliest, and

- would require a judgement that changes to the annual contribution limit and/or the transfer restrictions on NEST were not required during the implementation period.

Consultation Questions

Q12. **Is the end of implementation the appropriate time to remove the annual contribution limit and the transfer restrictions?**

Q13. **What would be the impact on individuals, employers, NEST and other pension providers of this approach?**

9 The following approaches consider removing or amending the annual contribution limit and/or the transfer restrictions before February 2018. These are separated into those that consider the transfer restrictions and those that address the annual contribution limit. These can be considered independently or in combination.

Transfer Restrictions

Approach 2: Amend the transfer restrictions for individuals specifically to allow NEST to participate in an automatic transfer approach for small pots

10 This approach would mean that there would be no restriction on small pots being consolidated, allowing NEST members to be able to benefit from automatic transfers as part of any broader industry wide solution.

11 An easement to the transfer restrictions could be constructed that would enable NEST to accept and make default small pot transfers and participate in a system of automatic transfers, but that would stop short of allowing:

- individuals to instigate the transfer of historic (small) occupational pension pots not covered by the automatic transfer system
- individuals to instigate the transfer of occupational pension pots that are above the small pots limit into NEST, and
- individuals to instigate the transfer of their NEST pot (small or large) out of the scheme before they reach NEST's minimum pension age (age 55).

12 This would mean that an individual could still accumulate multiple pension pots over their working life and the restrictions on transfers in and out of NEST would continue to prevent individuals who had a NEST account from consolidating their pension savings in one place (either in NEST or in another scheme).

13 Whilst these changes would provide some benefits to individuals, they would not overcome or have a significant impact on the concerns raised relating to the

influence of the annual contribution limit and the transfer restrictions on employer choice.

Consultation Questions

Q14. **Do you agree that NEST should be able to participate in an automatic transfer system?**

Q15. **What would be the impact on individuals, employers, NEST and other pension providers of this approach?**

Approach 3: Allow individuals to freely transfer pots into and out of NEST

14 This approach would benefit individuals as NEST members would be able to take greater ownership of their pension pots and instigate the consolidation of pots not covered by the proposed system of automatic transfers.

15 Members of NEST would be able to transfer in pots from other workplace schemes, but it would not be possible for non-members of NEST to 'walk-up' and request membership of the scheme. Membership of NEST will continue to be created through an enrolment event where an employer uses NEST and enrols workers for the purposes of automatic enrolment.

16 Members of NEST would also be free to transfer their NEST pot to another scheme to consolidate their pension saving. This would provide symmetry and place NEST members in the same position as those using other occupational pension schemes.

17 Again, while this approach would help individuals manage their savings over their working life, we would not expect it to address the issues identified in this document relating to the impact of the annual contribution limit and the transfer restrictions on employer choice.

Consultation Questions

Q16. **Should NEST members be allowed the same transfer rights as members of other occupational pension schemes, and if so from when?**

Q17. **What would be the impact on individuals, employers, NEST and other pension providers of this approach?**

Approach 4: Enable NEST to accept bulk transfers

18 This approach would enable NEST to be considered alongside other scheme providers where an employer is seeking to consolidate historic trust-based

defined contribution pension arrangements into the scheme they will use to automatically enrol their workers.

19 In assessing possible providers of their future pension scheme, an employer may consider NEST as the most appropriate scheme for their wider workforce, but face a trade-off between that and an administrative preference to find a single scheme solution for their workforce that enables them to consolidate trust-based defined contribution legacy pots for a proportion of their workforce who have had access to pension savings previously.

20 It would not allow assets held in contract based schemes being transferred into NEST. Bulk transfers can only be instigated by a trust based scheme and the scheme's trustees/the sponsoring employer will have needed to consider whether a bulk transfer is in all the members' interests before a transfer can be completed. It would allow deferred members of a legacy scheme to become members of NEST outside of automatic enrolment.

Approach 5: Allow bulk transfers, but only where the average value of pots across a specific bulk transfer is no more than a set amount

21 This would also enable NEST to be considered alongside other scheme providers where an employer is seeking to consolidate historic trust based defined contribution pension arrangements into the scheme they will use to automatically enrol their workers. But this approach ensures that NEST remains focussed on its target market of low to moderate earners.

22 This approach would restrict NEST to accepting only those bulk transfers where the average value of a pot in the bulk transfer was no more than a set amount. As an example, the set amount could be linked to the median dormant pot size – around £5,000[41].

23 While applying a limit on the average size of a pot within a bulk transfer might provide reassurance that NEST will stay focussed on its target market, it does pose some implementation issues, for example what would happen if the revised condition was not adhered to by NEST.

24 This approach would also not address a situation where an employer with a workforce generally suited to NEST and seeking a single scheme solution may have historically only offered pensions to a small number of workers that are middle managers and above. As a result of higher earnings, lower churn and generous contribution rates the average size of pots built up within their existing small trust-based scheme might be above the set amount.

Consultation Questions

[41] Crawford, R and Tetlow, G (2012) *Fund Holdings in Defined Contribution Pensions*, Institute for Fiscal Studies

Q18. **Should bulk transfers into NEST be facilitated?**

Q19. **What would be the impact on individuals, employers, NEST and other pension providers of each of these approaches?**

The Annual Contribution Limit

Approach 6: Increase the baseline annual contribution limit

25 This approach would give additional headroom to employers before the contribution limit posed practical problems for their workforce, and to individuals who wanted to make additional contributions. This may also give a wider group of employers the ability to use NEST as a single scheme for their workforce, and diminish for some employers the perceived complexity.

26 However it does not completely overcome the issues of complexity that are associated with the operation of an annual contribution limit, and might still cause employers to dismiss NEST in the early stages of the consideration process.

27 NEST would still have to maintain processes for monitoring contributions and processing refunds (although the volume of refunds would be reduced). In addition, more generous employers or individuals wishing to make ad-hoc contributions would still be prevented from doing so by a contribution limit at any level.

Approach 7: Place an obligation on NEST that a fixed percentage of members must not breach the contribution limit during the course of the year

28 This approach would ensure NEST remained focussed on its target market of low to moderate earners, but allow flexibility for smaller employers to have a single scheme solution.

29 This would provide some flexibility to NEST, but would require monitoring of the contributions made by its members on an ongoing basis. As an example, the percentage could be fixed at 95%, as earnings analysis shows that 95% of employees of small firms are not going to breach the contribution limit assuming the statutory 8% contributions on earnings above the trigger.

30 Additionally, this would reduce any perceived barriers for employers, whose workers are predominantly outside the target market, choosing NEST to fulfil their duties.

31 However the existence of the quota might still provide some issues in terms of complexity for employers. It could also add a considerable burden on NEST in trying to ensure it remained within the limits of the quota - and raises a question over what should happen if the revised condition is not met by NEST.

Approach 8: Remove the annual contribution limit at a specific point during staging

32 This approach ensures that employers with a duty date after the limit is removed would be able to consider using NEST, alongside other available schemes, as the single scheme solution for their workforce without the complexity associated with the annual contribution limit.

33 The Select Committee argued that if the Government waited until 2017 to deal with concerns raised about the annual contribution limit and the transfer restrictions, the overwhelming majority of employers will already have chosen their pension scheme and it will be too late to rectify the situation. Evidence[42] shows that – at minimum statutory contributions - only around 2 per cent of private sector employees working for micro employers earn enough to trigger the contribution limit, compared with around 8 per cent of employees working for large employers.

34 Potential dates could be:

- April 2014 - for employers with less than 250 employees; or
- June 2015 - for employers with less than 50 employees

Consultation Questions

Q20. **Are changes to the annual contribution limit required?**

Q21. **What would be the impact on individuals, employers, NEST and other pension providers of each of these approaches?**

All Approaches

35 We have set out above a range of possible alternative approaches that could address the concerns raised by the Work and Pensions Select Commitee.

36 These are not intended to be exhaustive and we invite proposals for alternative approaches or changes in the rules which could address the concerns that have been raised or to help employers and members in particular circumstances.

Q22. **Which of the approaches – or combinations of approaches – achieve the optimum balance between focussing NEST on its target market and enabling employers to meet their automatic enrolment duties whilst supporting good pension savings outcomes for individuals?**

Q23. **Are there alternative proposals which address the concerns that have been raised?**

[42] DWP analysis of Annual Survey of Hours and Earnings, 2011

7 Summary of Questions and Processes

Questions

Chapter 3 – The Supply Side Landscape

Q1 What evidence is there that the current downward pressure on charges is sustainable as smaller, less profitable employers start to meet their automatic enrolment duties? Is this relevant in considering the impact of the annual contribution limit and the transfer restrictions on NEST?

Q2 What evidence is there that the current pension industry has the capacity to serve the peaks in employer demand and put solutions in place to meet the demand for good quality, low-cost schemes? Is this relevant in considering the impact of the annual contribution limit and the transfer restrictions on NEST?

Q3 Do you agree that NEST should be able to fully participate in any automatic transfer solution?

Chapter 4 – Employer Choice

Q4 What evidence is there that the annual contribution limit and the transfer restrictions placed on NEST are or will influence employers' decision making?

Q5 Is there evidence of employers feeling unable to choose NEST for their workers due to the annual contribution limit and/or the transfer restrictions?

Q6 Is there evidence that employers (of any size) are prioritising or will prioritise a single scheme solution for automatic enrolment?

Q7 Is the existence of the annual contribution limit and/or the transfer restrictions on NEST adding to the cost to employers of responding to automatic enrolment?

Q8 Is there evidence that the impact of the annual contribution limit and/or the transfer restrictions on employer decisions is leading to or will lead to sub-optimal pension outcomes for workers?

Q9 What factors should the Government take into account when considering the likely impact of the annual contribution limit and the transfer restrictions on employer choice as smaller employers are brought into the reforms?

Chapter 5 – Consumer Interests

Q10 How should the Government best protect consumer interests? Would a different policy response be appropriate for smaller employers?

Q11 Are there other aspects of consumer detriment relating to the annual contribution limit and/or the transfer restrictions on NEST that the Government should consider?

Chapter 6 – Discussion of Possible Alternative Approaches

Approach 1: Removing the annual contribution limit and the transfer restrictions altogether at the end of staging (February 2018)

Q12 Is the end of implementation the appropriate time to remove the annual contribution limit and the transfer restrictions?

Q13 What would be the impact on individuals, employers, NEST and other pension providers of this approach?

Approach 2: Enabling automatic transfers

Q14 Do you agree that NEST should be able to participate in an automatic transfer system?

Q15 What would be the impact on individuals, employers, NEST and other pension providers of this approach?

Approach 3: Individual transfers

Q16 Should NEST members be allowed the same transfer rights as members of other occupational pension schemes, and if so from when?

Q17 What would be the impact on individuals, employers, NEST and other pension providers of this approach?

Approach 4: Bulk transfers into NEST

Q18 Should bulk transfers into NEST be facilitated?

Q19 What would be the impact on individuals, employers, NEST and other pension providers of each of these approaches?

Approach 5: The annual contribution limit

Q20 Are changes to the annual contribution limit required?

Q21 What would be the impact on individuals, employers, NEST and other pension providers of each of these approaches?

All Approaches

Q22 Which of the approaches – or combinations of approaches – achieve the optimum balance between focussing NEST on its target market and enabling employers to meet their automatic enrolment duties whilst supporting good pension savings outcomes for individuals?

Q23 Are there alternative proposals which address the concerns that have been raised?

Call for evidence arrangements

This call for evidence is aimed at employers, employee representatives and pension industry professionals, including occupational pension and workplace personal pension scheme administrators, payroll administrators, accountants, payroll bureaux, Independent Financial Advisors and Employee Benefit Consultants. Comments from workers and the general public are also welcome.

This call for evidence seeks views on the impact of the annual contribution limit and the transfer restrictions placed on the National Employment Savings Trust. In particular, it seeks views on:

- whether the percieved complexity of these two constraints is inhibiting employer choice, even where the workforce is in NEST's target market
- the extent in which commercial providers are able to supply low-cost provision to a very diverse range of employers as automatic enrolment gathers pace, and
- whether the balance between employer choise and consumer interests shifts as automatic entrolment captures smaller employers.

This call for evidence applies to the UK.

Duration of the call for evidence

The call for evidence begins on 6 November 2012 and runs until 28 January 2013. It is being conducted in line with the new Cabinet Office Consultation Principles (http://www.cabinetoffice.gov.uk/resource-library/consultation-principles-guidance).

The key principles are:

- departments will follow a range of timescales rather than defaulting to a 12-week period, particularly where extensive engagement has occurred before

- departments will need to give more thought to how they engage with and consult with those who are affected
- consultation should be ‘digital by default’, but other forms should be used where these are needed to reach the groups affected by a policy, and
- the principles of the Compact between government and the voluntary and community sector will continue to be respected.

This call for evidence is available on the Department’s website at:
http://www.dwp.gov.uk/consultations/2012

Please send your responses, preferably by email to:

jane.woolley@dwp.gsi.gov.uk

Or by post to:

Jane Woolley
Department for Work and Pensions
Enabling Retirement Savings Programme
1st Floor, Caxton House
6-12 Tothill Street
London SW1H 9NA

Please ensure your response reaches the Department by 28 January 2013.

When responding, please state whether you are doing so as an individual or representing the views of an organisation. If you are responding on behalf of a larger organisation, please make it clear who the organisation represents, and where applicable, how the views of members were assembled.

Any queries about the subject matter of this call for evidence should be made to Jane Woolley at jane.woolley@dwp.gsi.gov.uk

We have sent this call for evidence document to a number of people and organisations who have already been involved in this work or who have expressed an interest. Please do share this document with, or tell us about, anyone you think will want to be involved in this consultation.

Freedom of information

The information you send us may need to be passed to colleagues within the Department for Work and Pensions, published in a summary of responses received and referred to in the published response document.

All information contained in your response, including personal information, may be subject to publication or disclosure if requested under the Freedom of Information Act 2000. By providing personal information for the purpose of the public consultation exercise, it is understood that you consent to its disclosure and publication. If this is not the case, you should limit any personal information which is provided, or remove it completely. If you want the information in your response to the consultation to be kept confidential, you should explain why as part of your response, although we cannot guarantee to do this. We cannot guarantee confidentiality of electronic responses even if your IT system claims it automatically.

If you want to find out more about the general principles of Freedom of Information and how it is applied within DWP, please contact:

Central Freedom of Information Team
Department for Work and Pensions,
4th Floor, Caxton House,
Tothill Street,
London,
SW1H 9NA

Email: freedom-of-information-request@dwp.gsi.gov.uk

More information about the Freedom of Information Act can be found on the website of the Ministry of Justice, Freedom of Information pages.

Feedback on this call for evidence

We value your feedback on how well we consult or seek evidence. If you have any comments on the process of this call for evidence (as opposed to the issues raised) please contact our Consultation Coordinator:

Elias Koufou
Department for Work and Pensions' Consultation Coordinator:
2nd Floor, Caxton House,
Tothill Street,
London,
SW1H 9NA
Phone: 020 7449 7439
Fax: 020 7449 5089

Email: caxtonhouse.legislation@dwp.gsi.gov.uk

Please also make any suggestions as to how the process could be improved further.

If you have any requirements that we need to meet to enable you to comment or to provide evidence, please let us know.

The responses to the call for evidence will be published in a report on the DWP website that will summarise the information received and any action that we propose to take as a result.