Department for Work & Pensions

Supporting automatic enrolment

The Government response to the call for evidence on the impact of the annual contribution limit and the transfer restrictions on NEST

Presented to Parliament by the Secretary of State for Work and Pensions by Command of Her Majesty
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Foreword by the Minister of State for Pensions

Automatic enrolment into workplace pensions represents a step-change in the pensions landscape. In the last year, Britain's largest firms have automatically enrolled around 670,000 workers into pension saving for the first time. Building on a highly successful Government advertising campaign and effective workplace communications, opt-out rates have so far been lower than expected. Overall, the programme is on course to deliver between six and nine million people newly saving or saving more into a workplace pension.

A crucial part of the automatic enrolment landscape is NEST – the National Employment Savings Trust. NEST was set up by Government to ensure all employers have access to a high-quality, low-cost option for workplace pension provision. Whilst the market has always provided for larger firms and higher earners, NEST was created specifically to ensure that smaller firms and low to moderate earners also have access to quality pension provision.

To ensure that NEST focused on this 'target market', the previous Government legislated to constrain NEST in two particular ways – an annual contribution limit, currently £4,500 a year, and restrictions on transfers in and out of NEST, which prevents bulk transfers of existing schemes and limits transfers by individual scheme members.

In summer 2010, the Department for Work and Pensions commissioned an independent review – *Making Automatic Enrolment Work* – to consider whether the framework for automatic enrolment was fit for purpose. The review concluded that the basic architecture, including NEST, was appropriate, but that the constraints on NEST should be lifted in 2017. More recently, the Work and Pensions Select Committee recommended in 2012 that the constraints should be lifted at once, expressing concern that some firms might not be able to use NEST, resulting in consumer detriment.

In response, the Government published a Call for Evidence in late 2012, to seek views on the future of the NEST constraints. This document summarises the replies that were received and the Government's response.

The Government believes that requiring NEST to focus on this target market has been very successful. NEST now has over 250,000 members, up from around 130,000 in April. However, with large numbers of medium and smaller firms due to start enrolling their workers in the next few years, more than ever we need to focus on helping these smaller firms get ready to enrol their workers. NEST, with its special focus on those workers with lower earnings, will be a key part of the solution.

NEST has thought hard about its design; it has aimed its research, communications, use of language, investment and decumulation strategies at its target market. It is working, and we need this to continue. Therefore, to make sure we achieve our aim of getting people saving, we have decided that NEST must continue to focus on its target group without any distractions.

The responses to the Call for Evidence revealed a perception that the restrictions placed on NEST prevent it from serving the low to moderate earners and smaller employers it was intended for. However, I am pleased to say the reality is quite the opposite. With mandatory contributions of just two per cent on a band of earnings, with at least one per cent from firms, no employer contributing at this level, or the full eight per cent on the band, will exceed the annual contribution limit.

However, we need to look to the future, to ensure NEST remains influential in the marketplace, and continues to help drive up standards and best practice. The minimum contribution will also rise over time. It will increase to a combined contribution of 5% in October 2017 and 8% in October 2018. Therefore, in line with the recommendations of the independent *Making Automatic Enrolment Work* review, I intend to legislate as soon as possible to lift the contribution limit from 2017 so that come 2017, when current employers have enrolled their workers, employers can be certain that NEST will continue to be an appropriate scheme for them.

With regard to individual transfers, we agree that NEST should be part of the automatic transfer solution for which we are currently legislating. Therefore, we will lift the restrictions on individual transfers in and out of NEST to coincide with the start of the 'pot-follows-member' regime. The ban on bulk transfers will remain in place until the end of the main roll out period for automatic enrolment in April 2017, when it will then be lifted.

We believe that the creation of NEST has played a crucial role in the early success of automatic enrolment. NEST has focused on its target market and has innovated to serve the needs of those in that market. As automatic enrolment moves on to cover medium and smaller firms, we want NEST to continue its excellent work, whilst signalling now that beyond 2017 NEST will be put on a similar footing to other providers in the wider pensions market.

Steve Webb MP
Minister of State for Pensions

Executive summary

Automatic enrolment commenced in July 2012, with the largest employers. It will affect 1.2 million employers – the vast majority being small and medium sized employers (SMEs[1]) – and around 11 million people will be eligible, with six to nine million people newly saving or saving more[2]. NEST was established to underpin automatic enrolment by providing a workplace pension scheme for any employer who wished to use it to meet their automatic enrolment duties. It was set up to focus on a target market of smaller employers and low to moderate earners, who the existing pensions industry had found it more difficult to serve. To ensure that NEST remained focused on this target market, two constraints were placed on the scheme – a cap on annual contributions and restrictions on transfers in to and out of the scheme. These constraints were always a temporary measure and there is already a statutory requirement to review their effect in 2017, once roll out of automatic enrolment is complete.

The Department for Work and Pensions published a Call for Evidence in November 2012. It invited views and evidence pertinent to whether the annual contribution limit and the transfer restrictions worked in the way that they were intended, or whether there was a case for change. This response sets out the views, evidence and information gathered as a result of the Call for Evidence and the Government's proposed course of action.

1 Small and medium employers, defined as an employer with fewer than 250 employees.
2 Workplace pension reform: digest of key analysis, July 2012. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/196615/wpr_digest_0712.pdf.pdf

Introduction

Chapter 1 sets out the policy background to automatic enrolment and NEST. It describes the enormous challenge of introducing automatic enrolment, the current state of the market and the capacity issues that may lie ahead. It articulates NEST's role and the importance of NEST continuing to focus on its target market during the introduction of automatic enrolment.

Annual contribution limit

Chapter 2 looks at the impact of the annual contribution limit, what it was intended to do and how it might affect consumer interests and employer choice. The responses showed that there was a perception amongst some that the annual contribution limit could cause issues for consumers and employers. However, the chapter sets out that the contribution limit was designed to include flexibility, allowing consumers – the majority of whom will be on low to moderate earnings – to make significant contributions on top of the legal minimum. It looks at whether NEST can be used as a single scheme by SMEs and the evidence is that most SMEs just want to contribute the minimum, meaning they can definitely use NEST as a single scheme solution and all of their workers will have significant scope to make extra voluntary contributions.

Transfer restrictions

Chapter 3 considers restrictions on individual and bulk transfers, what the original purpose was and the impact on consumers' ability to consolidate their pension saving. The evidence showed a broad consensus that the restrictions on individual transfers should be lifted to enable NEST to participate in any automatic transfer solution. It also looks at whether bulk transfers are a priority for SMEs looking to use NEST. It sets out that the restrictions help to provide market stability and ensure administrative simplicity for NEST during the automatic enrolment implementation period.

Government response

Chapter 4 sets out the Government's response to the Call for Evidence and next steps. The Government's rationale is that NEST is doing well, the constraints are working to keep NEST focused on its target market and there is no clear evidence that the constraints have caused employers any difficulties so far. However, it has been highlighted that there is a perceived barrier to access caused by the constraints. It therefore concludes that the Department and NEST should provide a clear message on the impact of the constraints and that these constraints will be lifted when contributions rise above two per cent, the point at which there is a higher risk of reduced flexibility for NEST members to make significant extra contributions.

Summary of key proposals

The constraints are working to ensure NEST focuses on low to moderate earners and smaller employers, and getting these employers and workers into the scheme during roll out. This will ensure the successful implementation of automatic enrolment and the longer term aims of the reforms. However, the Government wants to provide employers with certainty that the constraints will not have any bearing on them or their workers in the longer term if their circumstances change. Government is therefore proposing to:

- legislate to remove the individual transfer restrictions to coincide with the launch of automatic transfers
- legislate as soon as possible to lift the other constraints from April 2017

The Department will also work closely with NEST, the pensions industry and employer groups to manage the perception that the constraints are a barrier to employer choice. This is to ensure that employers are clear about the actual impact the annual contribution limit and the transfer restrictions will have on them and their workers. The Department will also work with the Pensions Regulator to consider how to improve the call to action letters sent out to employers in advance of their staging date.

Introduction 1

Policy Background

1.1 The UK is facing a significant challenge to providing income and security in retirement. Less than one in three private sector workers are saving into a pension, and around 11 million people are not saving enough to achieve the retirement income they would like. Without action, this would increase pensioner poverty, place unsustainable pressure on the state, or both.

1.2 The UK is tackling this through:

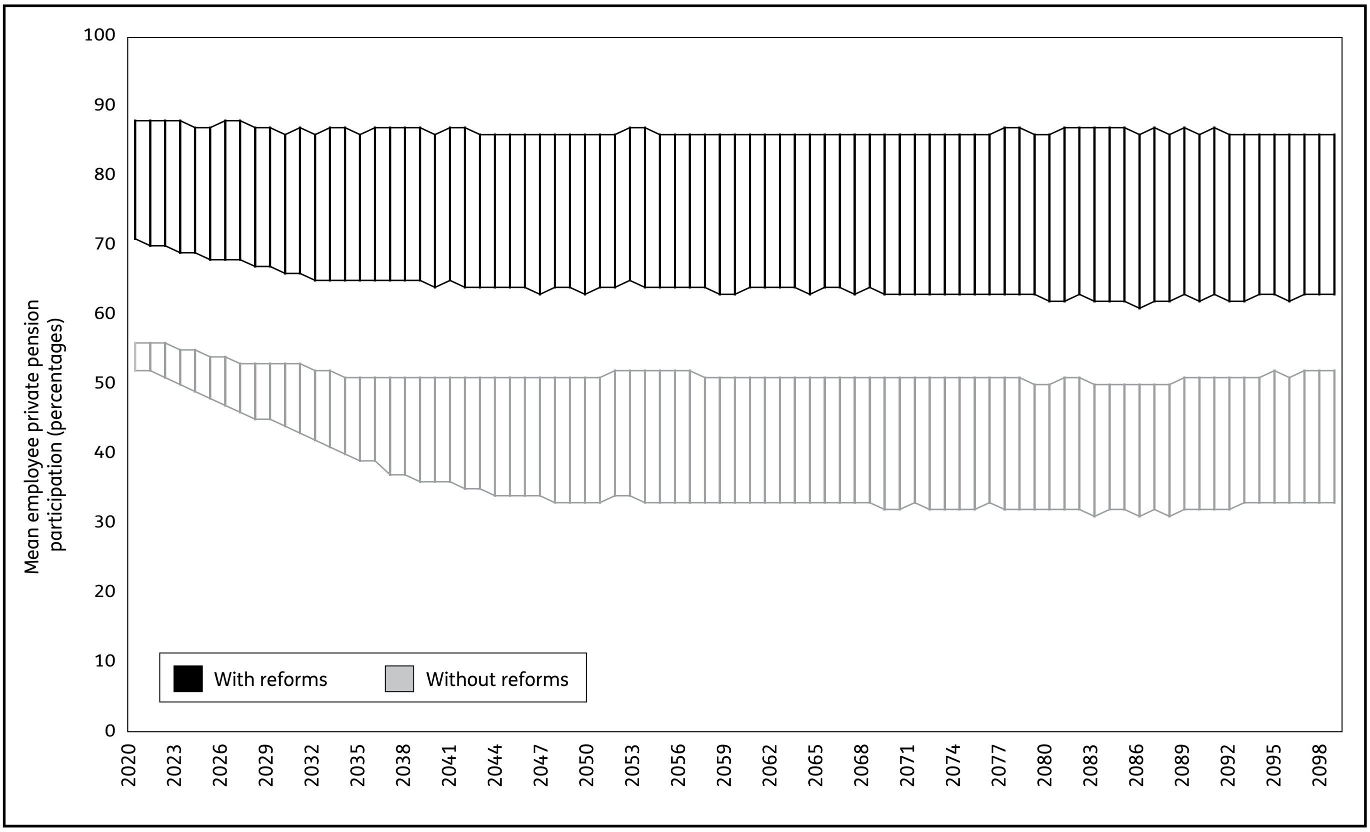
- reforms to the State Pension – equalisation of and increases in State Pension age and simplification of the State Pension system to provide a solid foundation for individual saving; and
- a duty on all employers to automatically enrol eligible workers into a workplace pension with the incentive to save reinforced by a mandatory employer contribution

Automatic enrolment challenge

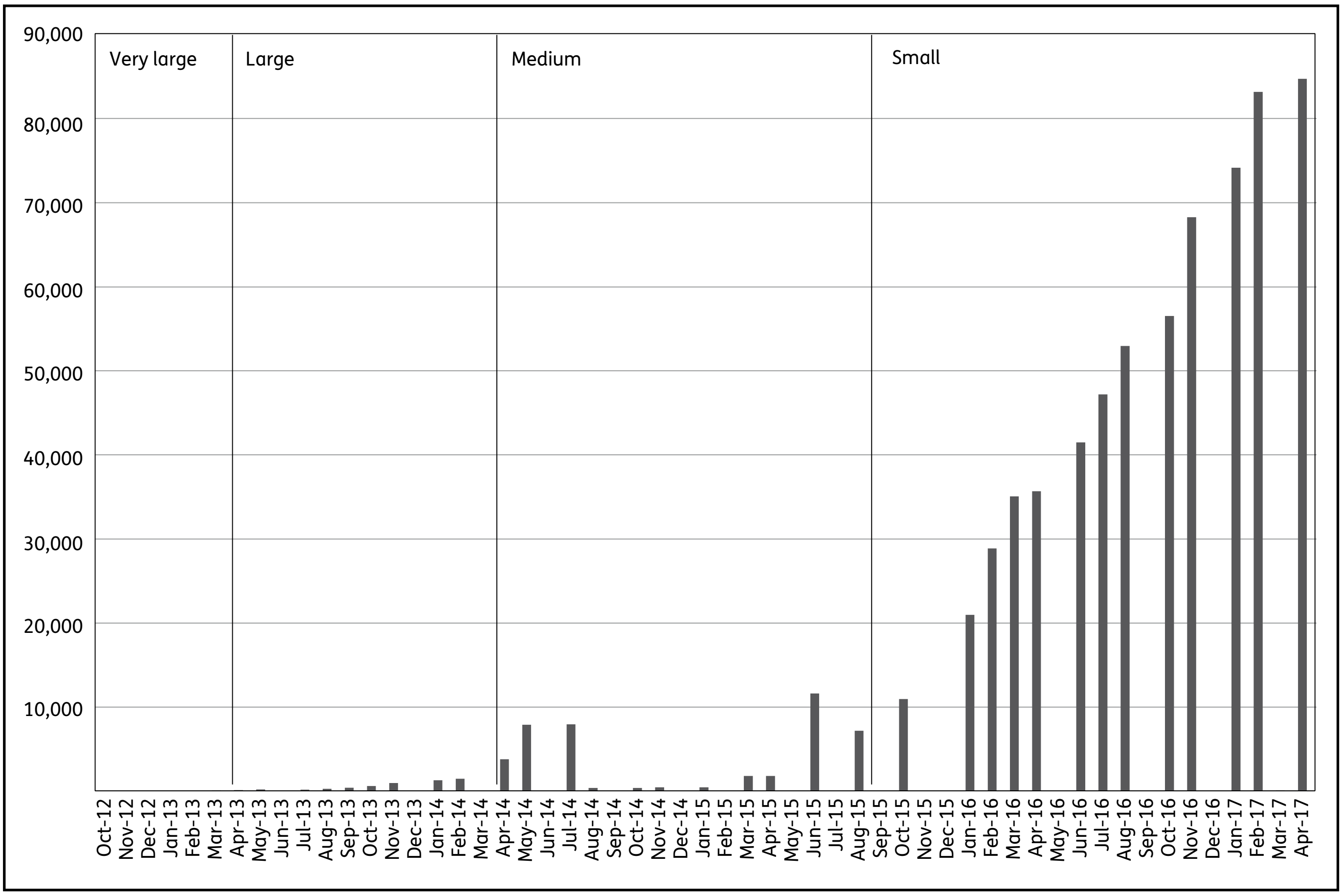
1.3 Automatic enrolment commenced in July 2012 with the very largest employers and ends – with the very smallest employers – in April 2017[3]. Around 11 million people will be eligible, with six to nine million people newly saving or saving more[4]. Reform on this scale will transform the UK's long-term savings culture, delivering social change on an unprecedented scale. Even under pessimistic assumptions about the number of people who might opt out of pension saving, automatic enrolment should lead to much higher participation in all workplace pensions than without the reforms – see Graph 1[5]. This will result in an extra £8 to 12 billion[6] invested in pension saving each year once implementation is complete.

[3] New employers created during the implementation period will be staged in between May 2017 and February 2018.
[4] Workplace pension reform: digest of key analysis, July 2012. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/196615/wpr_digest_0712.pdf.pdf
[5] Workplace Pension Reforms: Baseline Evaluation Report, July 2012. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193454/rrep803.pdf
[6] Workplace pension reform: digest of key analysis, July 2012. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/196615/wpr_digest_0712.pdf.pdf

Graph 1: High and low pension participation estimates (with and without automatic enrolment)



Graph 2: Profile of Employer Staging Dates



1.4 Graph 2 illustrates the delivery challenge particularly during the next three to four years with the number of employers staging in each month increasing substantially as around 1.2 million SMEs, with six million workers[7], are captured by the reforms. Many of these employers will have had little or no experience of providing substantive pension provision.

1.5 To overcome this challenge and ensure successful delivery a broad consensus is needed. Automatic enrolment requires a substantive resource commitment from employers supported by a responsive and effective provider community to ensure credibility and confidence in the reforms throughout roll out and beyond. Engaging this volume of employers and enrolling their workers is a considerable challenge for providers, particularly NEST that has a public service obligation to take any employer who wishes to use it to meet their automatic enrolment duties.

The Provider Market

1.6 The Government always expected expansion in the market reach of existing providers as a consequence of creating significant demand through automatic enrolment. The response by providers has been better than was originally anticipated and there has been recognition that building scale is a viable means of reducing the cost of supply. Some existing providers are now competing with NEST for low to moderate earners and smaller employers and new providers have also entered the market. As a result, large employers are finding good, low-cost automatic enrolment solutions for all segments of their workforce through a range of providers.

1.7 The Government welcomes the robust response of the pensions industry to the reforms. It is important that industry plays its part in meeting employer demand as implementation of automatic enrolment begins to capture SMEs.

1.8 The unprecedented demand that the introduction of automatic enrolment will place on the pensions industry has raised concerns about the capacity of providers to take on the business available. Recent research[8] suggests that by the end of 2013, providers will be running at about seven times normal capacity. Some of the largest providers have indicated that they are investing heavily in IT to allow employers to set up their schemes online. This investment could reduce the costs of providing schemes to small employers.

7 Supporting automatic enrolment: further analysis of earnings, participation and provision, July 2013. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209864/ad-hoc-supporting-ae-further-analysis.pdf

8 DC in practice, Towers Watson January 2013. http://www.towerswatson.com/en-GB/Insights/IC-Types/Ad-hoc-Point-of-View/2013/~/media/Pdf/Insights/IC-Types/Ad-hoc-Point-of-View/2013/Pension-auto-enrolment-provider-capacity.ashx

NEST's role

1.9 As an intervention in an existing market, NEST was established by Government with a clear remit to underpin automatic enrolment. NEST has a public service obligation (PSO) to admit any worker automatically enrolled by their employer, even if the cost of administering the account is greater than the revenue derived from charges. The PSO is the foundation of the Service of General Economic Interest (SGEI) for which NEST receives State aid. In 2010, the Department commissioned the *Making Automatic Enrolment Work* review[9], an independent review which looked at the scope of automatic enrolment and whether there was a need for NEST to exist in order for automatic enrolment to work. It confirmed that NEST is a necessary part of ensuring universal access to a workplace pension scheme at acceptable cost to the member, and even industry representatives did not feel that they could – or would wish to – provide a workable alternative to NEST.

1.10 The review also found that only 23 per cent of employers who did not provide any kind of pension scheme would be profitable compared with 91 per cent of employers who offered some kind of provision[10]. Further evidence[11] shows that the overwhelming majority (95 per cent) of unpensioned employers have less than 20 employees, demonstrating the challenge for the industry of serving smaller employers profitably.

1.11 For automatic enrolment to meet its aims, NEST has to provide a quality, low-cost workplace pension scheme focused on low to moderate earners and smaller employers – a target group for whom the market operated inefficiently. As we approach the peaks in the staging profile in 2014 for medium sized employers and from 2015 to 2017 for small employers, it is crucial that NEST is focused on helping these employers meet their automatic enrolment duties as capacity issues may mean that some providers cease seeking new business.

Constraints

1.12 The annual contribution limit and restrictions on transfers in to and out of the scheme were intended to ensure that NEST focused on its target market so that it complemented, rather than replaced, existing good quality pension provision. These constraints – whilst not integral to the State aid case – were cited in the original approval as reinforcing how Government sought to minimise any distortion in the market.

1.13 These constraints impact on the operational framework of the scheme. They were always intended to be temporary measures with legislation providing for them to be reviewed and removed once implementation of automatic enrolment was complete.

[9] See Chapter Four in: Making Automatic Enrolment Work, October 2010. Paul Johnson, David Yeandle and Adrian Boulding. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/139474/cp-oct10-full-document.pdf.pdf
[10] *ibid*.
[11] Supporting automatic enrolment: further analysis of earnings, participation and provision, July 2013. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209864/ad-hoc-supporting-ae-further-analysis.pdf

1.14 The Government believes that requiring NEST to focus on this target market has been very successful. The characteristics of the target market have been reflected in the development of its product and its business strategy, including:

- an award winning investment strategy specifically designed for low to moderate earners
- research into its target market is shared with other providers to help everyone learn about this unpensioned workforce and design products suitable for them
- 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
- a decumulation strategy for NEST members which offers members with pots as small as £1,500 (much lower than the industry norm) a way to purchase a retirement income

1.15 Furthermore, NEST's presence in the marketplace has also had a wider beneficial effect, ensuring that all employers now have a greater range of good quality, low-cost pension schemes to choose from. NEST's presence has helped to drive down charges[12], improve scheme governance and enhance member communications across the industry.

Call for evidence

1.16 These constraints have been the subject of sustained interest. In 2010, the *Making Automatic Enrolment Work* review, concluded that there needed to be a holistic review of the industry transfer process to make transfers easier and recommended that by 2017 NEST should be able to make transfers in to and out of the scheme. In addition, the review suggested that the contribution limit could cause complexity for employers and consumers, and recommended that there was immediate legislation to confirm that the limit would be lifted in 2017.

1.17 In 2012, as part of its broad inquiry into automatic enrolment and NEST, the Work and Pensions Select Committee recommended that the constraints should be lifted as a matter of urgency, as they felt the constraints were not operating in the way they were intended. However, evidence that the constraints were acting as a barrier to access was not unequivocal and there continued to be significant concern that NEST may lose its focus on the target market if the constraints were removed.

1.18 To address the Select Committee's concerns, the Department published a Call for Evidence in late 2012 inviting views and evidence pertinent to whether the annual contribution limit and the transfer restrictions worked in the way that they were intended, or whether there was a case for change.

1.19 The Call for Evidence closed on the 28 January 2013. A wide range of responses were received and the Department also conducted a series of in-depth discussions with a range of interested parties to gain further insight into the thinking behind the evidence presented.

1.20 The following chapters set out the key findings from the Department's evidence gathering and the Government's proposed course of action.

12 Likely responses to the workplace pension reforms: Qualitative research with pension providers and intermediaries, June 2011. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/139098/rrep753.pdf.pdf

The annual contribution limit 2

2.1 The annual limit on contributions was intended to focus NEST on its target market of low to moderate earners who were least well served by the existing market and minimise the impact of NEST on existing good quality schemes. The contribution limit was set at a level which would balance the twin aims of focusing the scheme on the target market and providing individuals with sufficient flexibility to save for their retirement. It is uprated annually by NEST in line with the Average Weekly Earnings Index (AWEI). For 2013/2014 the limit is £4,500.

Impact on consumers

2.2 Some respondents to the Call for Evidence expressed concern that the annual contribution limit would prevent NEST members making additional contributions over and above those made through their employer. Others felt it might discourage employers from making contributions to their workers' pensions above the legal minimum.

> "The current restrictions also prevent people, who are able to, from investing more into their NEST pension. This is likely to particularly impact on older workers who are trying to build up their savings close to retirement who may want to deposit lump sums received on redundancy or as a result of inheritance." **AGE UK**
>
> "In employers who have chosen NEST the upper limit on contributions will prevent better paid staff putting in extra contributions and/or deter employers from paying more than the minimum contributions for better paid staff." **TUC**

2.3 On the other hand, some respondents suggested that few of the individuals in NEST's target market would breach the contribution limit, and for those whose circumstances allowed additional saving beyond the limit, there were many other savings products available that may be as, or more, suitable.

> "The PPI's modelling shows that most low to median earners would be able to meet their target replacement rate by saving in NEST, without being affected by NEST's contribution limit." **PPI**
>
> "We would question whether the lifting of restrictions would make any real difference at this time. Very few individuals can afford to save £4,400 p.a. [sic] even taking into account employer contributions and tax relief." **The People's Pension**
>
> "For those who experience a significant change of financial circumstances that allow significant additional savings above and beyond the annual NEST cap, the private and government product market offers a range of choices, including tax-advantaged products." **IMA**

2.4 The minimum contribution levels for money purchase schemes will be phased in to help both employers and individuals adjust gradually to the additional costs of the reforms. Minimum contributions are currently a total of two per cent on a band of qualifying earnings[13] (between £5,668 and £41,450 in 2013/14) with at least one per cent from the employer. From October 2017, this will increase to a total of five per cent on the band of qualifying earnings with at least two per cent from the employer. From October 2018, the legal minimum contribution will be eight per cent on the band. If only the minimum is contributed, no matter how much an individual earns they will not breach the annual contribution limit.

2.5 Table 1 illustrates the amount of contributions that would be made to a worker's pension account based on contributions at the minimum rates but on all earnings from the lower qualifying earnings band. Where the employer decides to take this step beyond the minimum legal requirements, there remains scope even for those workers towards the top of the earnings profile to make additional contributions up to the £4,500 annual limit.

Table 1: Contribution rates on all earnings over minimum qualifying earnings over the implementation period at different salary levels

Implementation period	Total contribution rate (%)	Gross annual earnings				Median
		£15,000	£30,000	£45,000	£60,000	£26,000
Oct 2012 – Sept 2017	2	£187	£487	£787	£1,087	£407
Oct 2017 – Sept 2018	5	£467	£1,217	£1,967	£2,717	£1,017
Oct 2018 onwards	8	£747	£1,947	£3,147	£4,347	£1,627

2.6 Table 2 illustrates the level of total contributions required on earnings above the lower qualifying band before the NEST annual contribution limit is reached.

Table 2: Percentage contributions on earnings above lower qualifying band required to reach the annual contribution limit

Gross Annual Earnings	£15,000	£26,000 (Median)	£30,000	£45,000	£60,000
Earnings above lower qualifying band	£9,332	£20,332	£24,332	£39,332	£54,332
Contributions as a percentage of qualifying earnings	48%	22%	18%	11%	8%

[13] This includes tax relief on workers/employees pension contribution.

2.7 The level that the annual contribution is set at in relation to the legal minimum means that it is highly unlikely to impact NEST members and will not inhibit NEST's ability to serve its target market effectively. The illustration above shows the high level of flexibility a median earner enrolled into NEST would have.

Impact on employers

2.8 Of the 1.2 million employers affected by automatic enrolment, over 99 per cent are SMEs. This segment of the market is most likely to suffer a gap in supply due to a combination of lower earnings and reduced scale. This is the underlying rationale for establishing NEST, and it is important that NEST serves these smaller employers effectively.

2.9 The majority of respondents suggested that the annual contribution limit might impact on employers' choice of workplace pension scheme or increase costs for employers. In isolation or combination, many respondents suggested that the constraints could discourage SMEs from considering NEST, or discount NEST as difficult or impossible for them to use because they believe that:

- 'higher earners'[14] will exceed the limit
- they would need to use more than one scheme due to the limit
- they would need to undertake assessments to understand whether their workers may be affected by the limit
- the limit hampers flexibility and creates administrative costs where a worker:
  - has an increase in earnings
  - wants to contribute more voluntarily

2.10 Respondents often stated that smaller employers would want a single scheme solution to automatic enrolment as it would be simpler for the employer. Single schemes appear to be seen as providing greater simplicity and less administrative cost for smaller employers which may be important given their inexperience of pension provision and their likely concerns over cost.

2.11 There was a clear perception that the contribution limit would prevent an employer from being able to use NEST as a single scheme provider because NEST would be 'unable' to take higher earners.

> "Our concern was that the cap on contributions would prevent employers from offering a single workplace pension to all their employees, resulting in severe complexity, particularly for small and medium sized businesses" **Work and Pensions Select Committee**
>
> "Employers, particularly SMEs, who wish for the simplicity of a single scheme for their workforce will find this difficult with NEST" **Which?**

[14] There was no clear identification by respondents to the Call for Evidence of what represents a 'higher earner' – NEST has designed its product for those with median earnings of around £20,000, compared with median earnings of around £30,000 for those eligible for automatic enrolment who already have a pension.
http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/member-research-brief,PDF.pdf

2.12 However, a number of respondents suggested that there was no evidence the constraints were causing or would cause employers any difficulties.

> "We have not yet seen compelling and consistent evidence that the cap on contributions is causing a major challenge to employer decision-making and the success of NEST in securing business in its core target market." **IMA**
>
> "We believe there is little indication in these early days of auto-enrolment that employers' choices are being influenced by NEST's ability to accept transfers, or the contribution cap. However, we would agree that while the NEST contribution cap may not be a practical, real life barrier to employers' choice of provider it may pose a perceived barrier." **Aviva**

2.13 Some respondents also said that dual scheme solutions could potentially work for smaller employers without imposing an additional burden. NEST is already partnered with a range of other pension providers to provide a dual scheme solution for employers with workers on a wide range of earnings.

> "Some of our members are working in partnership with NEST or the People's Pension to provide a two tier pension scheme solution to employers. In some cases this appears as one scheme from the employer's point of view. This shows that even if an employer prefers a single scheme, this can be delivered through a two-tier approach." **ABI**

2.14 Recent Departmental research[15] demonstrates that 70 per cent of SMEs intend to contribute only the legal minimum to their worker's pension schemes. This means they could definitely use NEST as a single scheme solution as no workers could breach the limit, regardless of their earnings. Even if an employer did not want to impose the upper band 'cap' on the contribution and the total contribution was an uncapped eight per cent on all qualifying earnings, an individual would need to earn over £60,000 a year to breach the limit. As Tables 3 and 4 show there are few individuals who earn more than £60,000 who are employed by smaller employers.

Table 3: Earnings distribution for all private sector workers in the automatic enrolment eligible population

Firm size	Gross annual earnings				
	£0 – £14,999 (%)	£15,000 – £29,999 (%)	£30,000 – £44,999 (%)	£45,000 – £60,000 (%)	£60,000 + (%)
1 to 4	58	31	7	2	2
5 to 49	32	45	15	4	3
50 to 249	23	45	20	6	6
250+	26	39	20	8	7
Total	28	41	19	7	6

Source: DWP Analysis of ASHE, 2012

15 Supporting automatic enrolment: information on small and medium employers, July 2013. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209865/ad-hoc-supporting-ae-smes.pdf

Table 4: Earnings distribution for private sector workers without a workplace pension in the automatic enrolment eligible population

Firm size	Gross annual earnings				
	£0 – £14,999 (%)	£15,000 – £29,999 (%)	£30,000 – £44,999 (%)	£45,000 – £60,000 (%)	£60,000 + (%)
1 to 4	60	31	6	2	1
5 to 49	37	45	13	3	2
50 to 249	32	48	14	4	2
250+	42	43	11	3	2
Total	40	44	12	3	2

Source: DWP Analysis of ASHE, 2012

2.15 Most people[16] who earn upwards of £60,000 a year are already in pension saving. Average earnings among unpensioned workers are around £20,000[17]. Amongst those who are not currently saving in a pension, the core target group for automatic enrolment and NEST, only two per cent of workers earn over £60,000 and only five per cent earn over £45,000[18].

2.16 The combination of lower earnings and a desire to simply pay the legal minimum means that for the vast majority of smaller employers NEST will be entirely suitable as a single scheme. The annual contribution limit will not restrict the contributions they intend to pay or mean that they have to consider setting up a second pension scheme, particularly during roll out of automatic enrolment when minimum contributions are only two per cent. The busy stage of implementation for current employers ends in March 2017 and at that point the Government wants to give employers and individuals the opportunity to consider increasing contributions.

Impact of charges on employer choice

2.17 A number of respondents suggested that if employers chose not to use NEST because of the perception that the annual contribution limit added complexity, it could create a risk that those employers may then choose a high charging or otherwise inappropriate scheme for their workers.

> "An existing pension scheme may meet the legal requirements for auto-enrolment but may still fall short of modern and appropriate quality standards... There is, therefore, a risk that a greater proportion of workers will be enrolled into higher costs, less suitable pension schemes than would otherwise be the case if the NEST restrictions were lifted." **EEF**

2.18 But others felt that there was no evidence to support the claim that employers would choose a high charging or poor quality scheme. These respondents said that the industry was offering competitive charge levels and would continue to do so.

16 Supporting automatic enrolment: further analysis of earnings, participation and provision, July 2013. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209864/ad-hoc-supporting-ae-further-analysis.pdf
17 *ibid.*
18 *ibid.*

> "Our research shows that for schemes newly set up for automatic enrolment, the average AMC charged by our members is 0.52 per cent. When taking into account existing pension schemes that could be used for automatic enrolment and combining them with the newly set up schemes, the average AMC charged by our members is 0.61 per cent." **ABI**

2.19 As respondents pointed out, NEST's presence in the marketplace has had a beneficial effect on the market and employers now have a greater range of good quality, low-cost workplace pension schemes to choose from. We know that the large employers setting up schemes now are getting good deals for their workers. We welcome the steps taken by some in the industry who have committed to avoid using schemes with charges greater than one per cent of funds for automatic enrolment. The Department's research shows that the average AMC across private schemes is now 0.71 per cent for trust-based schemes and 0.95 per cent for contract based[19].

2.20 However, charges can have a significant impact on an individual's retirement outcomes and it is only right to consider putting in place protections as automatic enrolment continues to be rolled out. We want to ensure that all employers, irrespective of size, can get the best possible value for their employees. The Government announced that in light of the forthcoming Office of Fair Trading report a consultation will be published this autumn. This will set out proposals which will include introducing a charge cap for default funds in qualifying defined contribution schemes.

[19] Pension landscape and charging: Quantitative and qualitative research with employers and pension providers, 2012. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193451/rrep804.pdf

Transfer restrictions 3

3.1 The restrictions on transfers in to and out of NEST were designed to provide administrative simplicity for the scheme, enabling NEST to focus on its primary objective to support the introduction of automatic enrolment, without NEST needing to divert resources during implementation. The transfer restrictions do allow for a certain amount of flexibility for transfers in some circumstances:

- NEST members are allowed to transfer in pre-vested rights – these funds are known as cash transfer sums, and do not count towards the annual contribution limit
- transfers out are allowed from normal minimum pension age (age 55) for the purposes of consolidation
- pension credit transfers, arising from a pension share on divorce, are allowed and do not count towards the annual contribution limit
- where a member satisfies the trustee that they are suffering from incapacity, the transfer value provisions will apply

3.2 However it was recognised that over time and as the target market evolved, NEST would need to be able to accept all transfers to provide parity with other defined contribution occupational schemes and to ensure that members of NEST are not disadvantaged when compared with members of other pension schemes.

Individual transfer restrictions

3.3 The Government considers the ability to consolidate pension savings is important to the interests of consumers. Individuals with small amounts of pension saving may find it difficult to buy an annuity at competitive rates if they are unable to consolidate their savings, as many annuity providers require a minimum savings pot of £10,000[20].

[20] Government response to the consultation: Improving transfers and dealing with small pension pots (Cm 8402), July 2012. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/184963/gov-response-small-pots-automatic-transfer-sconsultation.pdf

3.4 Automatic enrolment will exacerbate an existing problem of individuals accumulating a number of small pension pots in multiple schemes over the medium to long term. Without reform we expect there to be up to 50 million dormant pension pots by 2050[21].

3.5 In this context, the Government set out plans in *Automatic transfers: consolidating pension savings*[22] in April 2013. The aim is to consolidate people's pension savings into their current employer's scheme as they move jobs. This will make it easier for people to keep track of their pension saving, plan better for retirement and secure a better income in retirement. Automatic transfers will take place between money purchase schemes, for eligible dormant pots under £10,000. The legal framework for automatic transfers is part of the Pensions Bill 2013.

3.6 There was almost universal agreement in responses to the Call for Evidence that NEST should be able to participate in any automatic transfer solution. This would allow NEST members to accrue the benefits that would accumulate from consolidation.

> "We think it is imperative that NEST should be able to participate in the automatic transfer system from the start in order to support the Government's aim of a comprehensive system" **Mercer**
>
> "Given that DWP research shows that employees will work for an average of 11 employers over their working lives, many employees will end up with some pension provision in NEST. If the government sees minimising the number of pots as a policy objective then it would be perverse to exclude NEST" **TUC**
>
> "Which? research has shown that ...62 per cent of people would like to be able to transfer their existing pension savings to their current pension" **Which?**

3.7 Several respondents said the restrictions on individuals making transfers in to and out of NEST were not in the interest of NEST members. However, there are demand and supply-side barriers that limit the number of member-initiated transfers[23]. In other pension schemes individuals already have the right to transfer pots in and out but they rarely do. Research suggests that one in six people have no idea where their pension is saved and more than four in five of workers failed to actively transfer their previous company pension funds across to their new employers[24].

3.8 Some concerns were raised about whether older workers could consolidate their pots nearer retirement. NEST members can already transfer out from normal minimum pension age (age 55) for the purposes of consolidation as they approach retirement.

3.9 It was clear from responses that employers were less concerned about the impact of individual transfer restrictions than they were about the annual contribution limit. This is because the individual transfer restrictions have a limited impact on the employer. However, a few employers were concerned about how the transfer restrictions might work in a dual scheme solution where members may move from one scheme to another.

[21] Government response to the consultation: Improving transfers and dealing with small pension pots (Cm 8402), July 2012. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/184963/gov-response-small-pots-automatic-transfer-sconsultation.pdf

[22] Automatic transfers: consolidating pension savings (Cm 8605), April 2013. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191697/automatic-transfers-consolidating-pension-savings.pdf

[23] Meeting future workplace pension challenges: improving transfers and dealing with small pension pots (Cm 8184), December 2011. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/176874/small-pension-pots-consultation.pdf.pdf.

[24] http://www.24-7pressrelease.com/press-release/prudential-reveals-fears-over-new-generation-of-lost-pensions-302796.php

Bulk transfers

3.10 A bulk transfer is where an employer transfers members' accounts from one trust-based scheme to another without the consent of each individual member. This requires the trustees of both schemes to confirm that it is in the best interest of their members and an actuarial sign off to certify that there is no detriment to individuals.

3.11 Once employers have chosen a workplace pension scheme they rarely change. This is primarily due to employer inertia and potential switching costs. The average contract based scheme (pre-reform) was set up 10 years ago. Employers with a scheme prior to automatic enrolment are likely to be more interested and engaged with pensions than employers who did not have a scheme prior to the reforms.

Table 5: Average year of commencement of scheme by scheme size[25]

Scheme Size	Trust Based	Contract Based
6–11	1991	1999
12–99	1992	2002
100–999	1998	2004
1000+	1994	2003
All	**1993**	**2001**

3.12 The Department estimates that only 14,000 SMEs, out of 187,000 who have substantive existing provision, have a scheme that could possibly be transferred to another scheme and that, of those who we expect to use NEST, only 5,000[26] would even consider a bulk transfer.

3.13 There were also some concerns raised by respondents to the Call for Evidence on what accepting bulk transfers might mean for NEST at a critical time while automatic enrolment is being rolled out.

> "No [to allowing bulk transfers], to prevent NEST becoming a "dumping ground" for legacy schemes." **Kingfisher**
>
> "It is our view that the transfer issue is not the immediate priority... Lifting the transfer restriction is likely to add a significant administration burden which is likely to increase the costs of administering NEST... We believed that NEST could become less competitive and less attractive to UK employers if it did accept transfers" **RBS**

3.14 Given the combination of employer inertia, switching costs, the need to achieve trustee and actuarial sign off and limited number of employers with schemes which could qualify for bulk transfer the impact of the ban on bulk transfers on employers will be small.

25 Pension landscape and charging: Quantitative and qualitative research with employers and pension providers, September 2012. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/193451/rrep804.pdf

26 Supporting automatic enrolment: further analysis of earnings, participation and provision, July 2013. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209864/ad-hoc-supporting-ae-further-analysis.pdf

Government response 4

4.1 Automatic enrolment into workplace pensions has been introduced to encourage and enable people to save more. The largest companies have already automatically enrolled their workers, but it is still early days. The roll out of automatic enrolment has some way to go but the early signs are that it is a success. The latest published registration figures[27] show that between October 2012 and May 2013 around 670,000 people were automatically enrolled into a workplace pension for the first time by over 600 employers.

4.2 NEST has been operational since July 2011, with a PSO to take any employer who wishes to use NEST for their automatic enrolment duties. The annual contribution limit and transfer restrictions combined with the PSO keep NEST focused on a target market of low to moderate earners and smaller employers. NEST has both supported the introduction of automatic enrolment so far, and had a positive impact on the wider pensions market. NEST's design including its research, communications, use of language, investment and decumulation strategies are aimed at its target market.

4.3 As a trust-based pension scheme where the trustees have a clear fiduciary duty to act in the best interest of members, NEST has given a strong voice to members in the pension market. This has helped to keep charges low and quality to remain high for all workers, no matter what their earnings, resulting in workers in all sectors being enrolled into a range of good quality and low-cost schemes – including NEST.

4.4 NEST has already successfully automatically enrolled over 250,000 members and is on target to enrol over 500,000 contributing members by the end of March 2014[28]. The Department estimates that of 1.2 million[29] SMEs, around 65 per cent will use NEST, even with the constraints in place.[30]

27 Data from the Pensions Regulator, June 2013.
28 NEST Corporate Plan 2013/14: http://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/NEST-corporate-plan-2013-2016,PDF.pdf
29 The Department estimates that there are less than 10,000 large employers see: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/196615/wpr_digest_0712.pdf.pdf
30 Supporting automatic enrolment: further analysis of earnings, participation and provision, July 2013. DWP. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209864/ad-hoc-supporting-ae-further-analysis.pdf

4.5 The Government is committed to making sure that the reforms continue to be a success. Effective implementation is important for building and maintaining consumer confidence in the automatic enrolment reforms.

Annual contribution limit

4.6 Some respondents to the Call for Evidence were concerned that the constraints would put unnecessary burdens on employers. In particular, they believed the annual contribution limit would mean employers would find it difficult or even impossible to use NEST as a single scheme solution.

4.7 However, the reality is quite different. With mandatory contributions until October 2017 of just two per cent on a band of earnings, with at least one per cent from firms, no employer contributing at this level will exceed the annual contribution limit. When contributions rise to eight per cent on a band of earnings all employers will still be able to fulfil their legal duties using NEST. The contribution limit is set at a level which allows significant contributions on top of the legal minimum despite our evidence showing that a large majority of SMEs will not be looking to contribute over the minimum.

4.8 The Government's view is that at this stage in implementation, the contribution limit will not restrict the way in which people save or cause employers to choose higher charging or poor quality schemes. Nor should the contribution limit have any impact on the vast majority of SMEs.

4.9 The priority now and until roll out is complete is to get many more people into the habit of saving into a workplace pension. To achieve this it is vital that NEST remains focused on its target market throughout the introduction of automatic enrolment, continuing to provide the best possible pension to those who are not well served by the existing market.

4.10 There are clearly some very strong concerns about whether the consumer interest test is met and whether NEST members are disadvantaged by being unable to contribute more to their pension than the current annual contribution limit. It is right that in the window between the end of roll out in March 2017 and before the automatic enrolment minimum contributions rise to five per cent in October 2017 the annual contribution limit should be lifted. Not only will this enable those individuals to pay more into their pot, it will also send a clear signal to employers that they can move towards more generous contribution levels if they choose to.

4.11 It is important that employers have certainty about the future when making decisions about which workplace pension scheme is right for their workers. The Government will therefore legislate as soon as possible to remove the contribution limit from April 2017. This will send a clear message to employers that the limit will not have any bearing on them or their workers in the longer term.

Transfer restrictions

Individual transfers

4.12 The key reason for imposing transfer restrictions was to help NEST focus on implementation, getting employers who want to use it signed up successfully and many more people saving into a pension. Automatic enrolment is a challenge for employers, but it is also an enormous challenge for the entire pensions industry – including NEST.

4.13 Many respondents raised concerns about capacity, particularly during the staging peaks from April 2014 onwards when around 1.2 million SMEs begin to reach their staging date. This will clearly be a huge test for NEST with its PSO to take any employer who wishes to use it to meet their automatic enrolment duties. The main priority for NEST remains the successful introduction of automatic enrolment throughout these peaks over the next few years.

4.14 Considering the importance of successful implementation of automatic enrolment and the limited number of member-initiated transfers the Government considers the right time to lift the restrictions on transfers is alongside the introduction of an automatic transfers solution. Removing the restrictions on transfers at this time will allow individuals to choose to consolidate any pension pot, even those with a value over £10,000.

Bulk transfers

4.15 The evidence to support allowing NEST to accept bulk transfers during implementation was limited. A transfer of existing rights is not a compulsory consequence of choosing a new scheme for automatic enrolment. Very few SMEs who are likely to use NEST have a scheme that could possibly be transferred. The Government wants NEST to focus on the primary aim of ensuring that employers are able to meet the new duties, and the weight of evidence does not support making a change earlier than April 2017.

4.16 However, once automatic enrolment has been introduced, NEST will be able to support those few employers who may wish to undertake a transfer without it distracting from its ability to perform its core task. For this reason the Government considers it appropriate – in line with the decision on the annual contribution limit – to legislate as soon as possible to give employers certainty and enable bulk transfers to take place from 2017. This will ensure that NEST remains focused on its primary purpose of ensuring that all employers are able to choose a qualifying scheme throughout implementation whilst giving employers certainty about the future.

Next steps

4.17 The Government recognises that legislation alone will not address the perception that these constraints are a barrier for smaller employers who should be considering NEST as a good value scheme for their workers. It is clear from the responses that the belief that an employer cannot use NEST as a single scheme solution is widespread.

4.18 To lift the restrictions as a result of a perception would not be a proportionate response and could divert NEST's attention to parts of the market that it is not specifically designed for, leaving it with less capacity to supply pension provision for its target market. This could put the successful implementation of automatic enrolment at risk. The Department, in co-operation with NEST, the pensions industry and employer groups needs to communicate clearly and effectively that the constraints are not a real barrier to SMEs using NEST to meet the automatic enrolment duties and that they will be removed in 2017. This is the best way of addressing any perception problems about the constraints.

4.19 The Government is also looking at other ways scheme selection decisions could be made easier for employers. As part of this the Department, with the Pensions Regulator, are looking at how to improve the letters that are issued to employers in advance of their staging date and the planning tool on the Pensions Regulator's website.

4.20 Legislating now to confirm the constraints will be lifted in 2017 will allow NEST and others to communicate to employers that they are only temporary. It will enable NEST to focus on supporting the successful implementation of automatic enrolment, ensuring that supply gaps are addressed and that all workers are enrolled into good quality, low-cost pension provision. This will send a clear message to employers that the constraints will not have any bearing on them in the longer term, helping them make an informed decision about which automatic enrolment pension scheme is suitable for them.

State aid

4.21 The annual contribution limit and transfer restrictions, although not integral to the case, were cited by the European Commission in their approval of State aid for NEST as being important to reducing market distortion. On this basis the Department will be seeking confirmation from the Commission that removing these constraints from April 2017 remains consistent with State Aid rules and we intend to consult on draft regulations as soon as possible.

Respondents

4.22 A wide range of views, evidence and information was gathered as part of the Call for Evidence. This included information gathered through: over 50 formal written responses from a diverse range of organisations and individuals; detailed discussions at forums run by the Automatic Enrolment Programme with employers, trade bodies and pensions intermediaries; and in-depth follow-up discussions with a range of stakeholders. We would like to thank all those who took the time to respond or discuss this issue with us.

Annex A
List of respondents

List of organisations who responded

AEGON
Age UK
Aon Hewitt
Association of British Insurers (ABI)
Association of Professional Financial Advisers
Aviva
Broadcasting, Entertainment, Cinematograph and Theatre Union (BECTU)
Capita
Confederation of British Industry (CBI)
Chartered Institute of Payroll Professionals (CIPP)
Chartered Institute of Personnel and Development (CIPD)
Chartered Insurance Institute (CII)
Consumer Focus
Engineering Employers' Federation (EEF)
Federation of Small Businesses (FSB)
Friends Life
Hymans Robertson
Institute of Chartered Accountants in England and Wales (ICAEW)
Institute of Directors (IoD)
Investment Management Association (IMA)
Jelf Group
Kingfisher
Law Society of Scotland
Legal & General (L&G)
Mercers
National Association of Pension Funds (NAPF)
National Employment Savings Trust (NEST)
NOW:Pensions
Orchid Group
Pensions Management Institute (PMI)
Pensions Policy Institute (PPI)
Prospect
Royal Bank of Scotland (RBS)
Royal Society of Arts (RSA)
Scottish Life
Scottish Widows
ShareAction (formerly FairPensions)
Society of Pensions Consultants
Standard Life
The People's Pension
Towers Watson
Trades Union Congress (TUC)
University of Kent
Which?
Work and Pensions Select Committee

Written responses were also received from a number of individuals and academics including Dr. Ros Altmann and Dr. Andy Tarrant.

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