House of Commons

Work and Pensions Committee

Lifting the restrictions on NEST

Fourth Report of Session 2012–13

HC 950

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Report, together with formal minutes

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The Work and Pensions Committee

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The Reports of the Committee, the formal minutes relating to that report, oral evidence taken and some or all written evidence are available in a printed volume.

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The current staff of the Committee are Carol Oxborough (Clerk), Daniela Silcock (Committee Specialist), James Clarke (Inquiry Manager), David Foster (Committee Media Adviser), Emma Sawyer (Senior Committee Assistant), Hannah Beattie (Committee Assistant).

Contacts

All correspondence should be addressed to the Clerk of the Work and Pensions Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 2839; the Committee's email address is workpencom@parliament.uk.

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Implementation of automatic enrolment into workplace pensions began in October 2012 with the largest employers and will continue this year for employers with 250 or more employees. From April 2014, employers with between 50 and 249 employees will begin to be required to enrol them in a pension scheme. The process is due to be completed for all existing employers by April 2017. By the end of the implementation process, an estimated 6-9 million people will be saving into a workplace pension scheme for the first time, or saving more into their existing scheme.

The National Employment Savings Trust (NEST) was established to offer a simple, low-cost pension scheme for employers and employees on low to moderate earnings when automatic enrolment into workplace pensions began.

NEST has a public service obligation (PSO) to be available to all employers who wish to use the scheme to meet their auto-enrolment requirements and to accept all individuals automatically enrolled into it. In recognition of this, NEST was established with public money and continues to receive loans and grant funding from the Department for Work and Pensions (DWP).

In addition to the PSO, the Government has placed a number of restrictions on NEST's operations. The two key restrictions are: a cap on the total level of annual contributions which can be paid into a NEST pension each year; and a ban on transfers in and out of NEST. The restrictions played a part in achieving a broad consensus across the pensions industry on introducing automatic enrolment. Under existing legislation, the restrictions will be reviewed in 2017.

In our 2012 report on automatic enrolment and NEST, we recommended that the two restrictions be lifted "as a matter of urgency". Our concern was that the cap on contributions would prevent employers from offering a single workplace pension scheme to all their employees, resulting in severe complexity, particularly for small and medium-sized businesses; and that the ban on transfers would prevent individuals from consolidating their separate pension pots, either into their NEST scheme or another pension scheme. We believed that the restrictions were likely to reduce the effectiveness of NEST in addressing the market failure in the pensions industry that it was designed to resolve, and would not serve the best interests of employers or individuals.

The Government's response to this recommendation was to launch a consultation on the restrictions in November 2012. The consultation ended in January. This report is our contribution to the Government's consultation.

The first round of auto-enrolment has proceeded without market failure and has seen the emergence of new entrants to the market, although there has also been lower than expected take-up of NEST by the largest employers.

Our very strong view, based on our original assessment, and on further clear evidence which has emerged as implementation of automatic enrolment has begun, is that the contributions cap and the ban on transfers should be lifted now, and should not be delayed until 2017.

The Government estimates that it takes employers between a year and 18 months to prepare for enrolling their employees into a pension scheme under the auto-enrolment requirements. It is therefore essential that the Government gets the detailed arrangements right now, so that employers in medium and small businesses have the clarity they need in sufficient time to make the right choices about pension schemes.

The Government has made clear that it intends to "fix" the issue of the ban on transfers in and out of NEST in order to implement its "pot follows member" solution to the existing problem of the proliferation of small pension pots. This seems to us to make it essential that this restriction is lifted as quickly as possible.

Removing the restrictions now will also help to ensure that the taxpayers' money which has been allocated to NEST is used most effectively, in allowing NEST to offer its services to the widest range of employees and to meet the automatic enrolment requirements of all employers who wish to choose NEST as their pension provider.

The European Commission has deemed that the Government funding for NEST is permissible under its state aid rules because the PSO ensures that NEST is not competing unfairly with other pension providers. There is also a question about whether the two restrictions remain necessary to meet the European Commission's rules on state aid. Lifting the restrictions may entail the Government providing further assurances about the state aid arrangements to the European Commission, but this should not constitute an obstacle to the restrictions being lifted now.

1 Introduction

Background

1. Under automatic enrolment, which began in October 2012, millions of employees will be automatically enrolled into workplace pension schemes for the first time. Employers will be required to establish a pension scheme for their employees and they must also make a contribution to each employee's pension (unless the employee opts out). These duties started first for the largest employers, but all current employers will be required to enrol their eligible employees in a pension scheme by 2017. The Government estimates that automatic enrolment will mean that 6 to 9 million people will be saving into a pension for the first time, or saving more into their existing scheme.[1]

2. The Government has established the National Employment Savings Trust (NEST) to offer a simple, low-cost pension scheme for employees on low to moderate earnings. NEST has a public service obligation (PSO) to 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 means that it has to be available to all employers who wish to use the scheme to meet their auto-enrolment requirements, including businesses that other pension providers may consider loss-making or not commercially viable.

3. In addition to the PSO, the Government has placed a number of restrictions on the operation of NEST. The two key restrictions are: a cap on the annual contributions an individual can make into NEST; and a ban on individuals transferring existing pension pots into or out of NEST. The restrictions are scheduled to be reviewed as part of an overall assessment of automatic enrolment in 2017.[2]

Our 2012 report

4. We examined the plans for automatic enrolment, including the NEST restrictions, in an inquiry which began in 2011. In our report published in March 2012, we recommended that the two key restrictions on NEST should be removed "as a matter of urgency". Our view was that the restrictions would result in severe complexity for small and medium-sized businesses, and would be disruptive both for individuals who wanted to consolidate separate pension pots into their NEST scheme and to employers who wanted the convenience of offering a single workplace pension scheme to all their employees. We believed that the restrictions were likely to reduce the effectiveness of NEST in addressing the market failure in the pensions industry that it was designed to resolve, and would not serve the best interests of employers or individuals.[3]

1 DWP, *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*, ("DWP Consultation on NEST Restrictions") November 2012, Executive Summary, para 1. For the timetable for auto-enrolment implementation see DWP, *Automatic Enrolment into a workplace pension: key facts, September 2012,* p 6

2 DWP Consultation on NEST Restrictions, Executive Summary, para 3 and p 12

3 Eighth Report of Session 2010-12, *Automatic enrolment in workplace pensions and the National Employment Savings Trust*, HC 1494, Summary and paras 170-176

5. The Government responded to our Report in May 2012. Its response to our recommendations on the NEST restrictions was that it would "reflect further" on the issues we had raised. It stated that:

> If there are barriers, or perceived barriers, to employers choosing NEST, where it is appropriate for them to do so, the Government needs to consider carefully what can be done to remove them. However, the evidence that the NEST restrictions are acting as a barrier is not unequivocal and the Government is conscious that the restrictions were designed to ensure that NEST's focus remained on its target market.[4]

The DWP consultation

6. On 6 November 2012, DWP announced a consultation on the annual contribution cap and the ban on transfers. It issued a Call for Evidence and invited views on whether the restrictions were working in the way that they were intended or whether there was a case for change. The Call for Evidence raised a number of questions but, in particular, it sought views on:

- whether the perceived complexity of these two constraints is inhibiting employer choice, even where the workforce is in NEST's target market;
- the extent to which commercial providers are able to supply low-cost provision to a very diverse range of employers as automatic enrolment gathers pace;
- whether the balance between employer choice and consumer interests shifts as automatic enrolment captures smaller employers; and
- whether NEST should be able to fully participate in any automatic transfer solution for small pension pots that is introduced (as the current restrictions on transfers would exclude NEST from a new system of automated transfers).[5]

7. In announcing the consultation, the Minister for Pensions, Steve Webb MP, referred specifically to the concerns raised in our report:

> This call for evidence explores the 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.[6]

The introduction to the consultation document also refers in some detail to our 2012 report. The consultation closed on 28 January 2013.

8. We published our 2012 report before automatic enrolment had begun. Implementation started in October 2012, with only the largest employers initially being involved. Full roll-

4 Second Special Report of Session 2012-13, *Automatic enrolment in workplace pensions and the National Employment Savings Trust: Government Response to the Committee's Eighth Report of Session 2010–12*. HC 154, pp 12-13 (response to recommendation in para 175 of the Report)

5 DWP Consultation on the NEST Restrictions, pp 22 and 41

6 HC Deb, 6 November 2012, col 38WS

out will not be achieved until 2017. However, an increasing number of employers and employees, including those in the smallest businesses, will be affected by auto-enrolment over the next few years. **We therefore welcome DWP's decision to look again at the implications of the NEST restrictions now, rather than waiting for the review of the overall operation of NEST planned for 2017.**

Scope of this report

9. This report is our response to the Government's consultation on the NEST restrictions. The consultation began while we were in the middle of a broad-ranging inquiry into Governance and Best Practice in Workplace Pension Provision. The NEST restrictions are a continuing concern to us and have been raised by a number of witnesses during the course of the inquiry. We believed that it was important to restate our views on the NEST restrictions in time for them to be taken into account in the DWP consultation. We therefore decided to publish this short report, following up our 2012 report on automatic enrolment and NEST, in advance of the wider-ranging report we plan to publish on pensions governance. We have drawn on the relevant evidence we have received during the governance inquiry to inform this report.[7]

10. We have not sought to re-examine all the detailed arrangements for automatic enrolment and the operation of NEST; these are set out in our 2012 report and in the DWP consultation document. Our aim in this report is to reconsider the arguments we heard from both sides about the NEST restrictions in our earlier inquiry in the light of new evidence which has emerged now that automatic enrolment has begun and to present our views so that they can be taken into account by the Government in coming to its final decision on whether the restrictions should be lifted now.

11. In this Report, our conclusions are shown in **bold type** and our recommendations are in ***bold italic*** type.

7 The oral and written evidence taken in the Pensions Governance inquiry is available in the Publications section of the Committee's website at www.parliament.uk/workpencom.

In the footnotes to this report, Ev is used for references to written evidence published in the volume of written and oral evidence received in the Pensions Governance inquiry (Volume II); Ev wxx is used for references to written evidence available in the volume of additional written evidence, published in electronic format only (Volume III).

2 Original rationale for the restrictions

NEST funding

12. The Government established NEST in advance of the introduction of automatic enrolment to fill the existing gap in the pensions market by offering a "simple, low cost pension scheme to individuals on low to moderate earnings" and to support "employers that the existing pensions industry does not serve well".[8] Employers can either choose NEST or a private provider that has met the qualifying criteria for their auto-enrolment scheme.

13. NEST has a public service obligation to be available to all employers who wish to use the scheme to meet their auto-enrolment requirements. Unlike private providers, NEST must therefore accept businesses that the existing market may consider loss-making or not commercially viable.[9] In recognition of this, the financing of NEST Corporation is met through a combination of loan and grant income funding from the Department for Work and Pensions (DWP), which is approved annually by Parliament.

14. NEST reported the loan sum to be £171 million at 31 March 2012.[10] The repayment date for the loan will depend on a number of factors, including NEST's performance. NEST pays a commercial rate of interest on the loan.[11] The grant from DWP was £10.8 million for the year ended 31 March 2012. NEST describe the grant as "sufficient, in effect, to reduce the interest payable on the loan from the commercial rate to the government rate of borrowing." NEST says that its grant income from DWP "is allowable under a ruling from the European Commission in July 2010".[12] We explore this further in the section on state aid below.

The two key restrictions

15. In addition to the public service obligation, the Government has placed a number of restrictions on NEST's operation. Our previous report explained that these restrictions had been developed as part of a broad consensus for introducing automatic enrolment, following the reports of the Pensions Commission which contained long-term and wide-ranging proposals for reform of pension provision.[13] The restrictions reflected a concern in the pensions industry that employers might shift their existing pension schemes into NEST and reduce the level of their pension contributions.[14] The two key restrictions which our previous report recommended should be lifted are: the cap on annual contributions;

8 See Eighth Report HC (2010-12) 1494 , para 148

9 See Eighth Report HC (2010-12) 1494, para 149

10 *NEST Corporation Annual Report and Accounts 2011/12, HC 375, July 2012*, p 77

11 *NEST Corporation Annual Report and Accounts 2011/12*, pp 57 and 61

12 *NEST Corporation Annual Report and Accounts 2011/12*, pp 61 and 71

13 Pensions Commission, First Report – *Pensions: Challenges and Choices,* 2004; and Second Report – *A New Pensions Settlement for the Twenty-First Century,* 2005

14 See Eighth Report, HC (2010-12) 1494, para 153

and the ban on transfers in and out of NEST. Existing legislation provides for these two restrictions to be reviewed in 2017 with the potential for them to be lifted from that point.[15]

Cap on annual contributions to NEST schemes

16. The Government has set a limit on the annual contributions that can be paid into a NEST pension scheme. The annual contribution limit is £4,400 for 2012–13.[16] DWP says that an individual would need to earn more than about £60,000 per year to exceed the annual contribution limit (based on a minimum contribution rate of 8% and contributions paid on earnings from the lower limit of the qualifying earnings band of £5,564 a year) and that it therefore only affects 6% of private sector employees.[17]

17. However, this still means that a number of employers who have employees on a range of earnings are not currently able to use NEST as a single pension provider. Employers choosing NEST for their lower-paid employees have to use an additional provider for the higher earners, or for employees for whom they want to make more generous contributions. There is a significant risk that employers faced with this situation will decide not to use NEST for any of their employees and will opt instead for a provider who can offer a scheme for their entire workforce and thus avoid complexity.

18. Some witnesses, notably the Association of British Insurers, took the view during our earlier inquiry that the contribution cap was justified in that it would be effective in keeping NEST focused on its target market of low and moderate earners. However, many others pointed out that, as well as hindering NEST's competitiveness and ability to offer value for money to customers, it would also work against NEST members who wished to make additional contributions. The cap also increases administrative complexity for NEST in terms of it having to check regularly whether the cap has been reached by individual employees.[18]

Ban on transfers

19. NEST cannot accept transfers in from other pension schemes; nor can a NEST scheme member transfer their pension pot to another pension scheme.

20. The UK currently has a significant problem with the number of small pension pots accrued by employees in occupational schemes. An individual who changes jobs several times in their working life, as increasingly is the norm, and who joins a new scheme with each new job, can easily end up with many small pots. In theory, employees can transfer small pension pots into a new employer's scheme when they take up a job, but witnesses in our previous inquiry highlighted how complicated and expensive it can be to try to do this or to combine multiple pots.[19]

15 DWP Consultation on NEST Restrictions, p 12

16 DWP Consultation on NEST Restrictions, pp 11-12

17 DWP Consultation on NEST Restrictions, p 12

18 Eighth Report, HC (2010-12) 1494, paras 155-160

19 Eighth Report , HC (2010-12) 1494, paras 161-166

21. The Government has recognised that this is a problem that is likely to grow as auto-enrolment is implemented. It has estimated that, under the current arrangements, there would be around 50 million dormant workplace defined contribution pension pots within the system by 2050, and that over 12 million of these would be under £2,000.[20] In December 2011 DWP launched a consultation seeking views on how to address this, highlighting that:

> We anticipate that automatic enrolment and a highly mobile jobs market will lead to a significant increase in the number of small dormant pension pots in our future pension system. The burden of these small pots is compounded by the fact that systemic barriers, like cost and complexity, prevent people from moving and consolidating their pensions into the one place.[21]

22. The Government published its response to the consultation on small pots in July 2012.[22] This set out the Government's preferred solution: a system where small pots would automatically transfer to the new employer's pension scheme on job changes. The response explained why this was DWP's preference as opposed to the "aggregator" model which some stakeholders favour. We will explore the wider issue of small pots in our governance report. Here we look at the implications of the Government's proposals for NEST.

23. DWP says that its assumption in the response to the small pots consultation was that "NEST would be involved in automatic transfers, and this was the basis of the Government's analysis".[23] However, while a ban on transfers in and out of NEST remains in place, the pot cannot follow the member if an employee is either auto-enrolled into NEST by a new employer or a new employer uses a different scheme, leaving previous contributions to NEST stranded. The Government has acknowledged the likely impact this would have:

> 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.[24]

24. The Minister has now confirmed, in oral evidence to us in January 2013, that the Government intends to address the NEST transfers issue to ensure that the small pension pots problem can be resolved by implementing the "pot follows member" solution he favours. He told us: "We will fix it. We have to fix it."[25]

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20 DWP, *Government response to the consultation: Improving transfers and dealing with small pension pots*, July 2012, Cm 8402, Executive Summary, p 10

21 See Consultations section of the DWP website at www.dwp.gov.uk/consultations/2011/small-pension-pots.shtml

22 DWP, *Government response to the consultation: Improving transfers and dealing with small pension pots*, July 2012,Cm 8402

23 DWP Consultation on NEST Restrictions, p 21

24 DWP Consultation on NEST Restrictions, p 21

25 Q 385

State aid

25. A question was raised in our previous inquiry about whether the two restrictions were necessary to meet the European Commission's (EC) rules on state aid. Some witnesses believed they were key to obtaining EC approval for the Government's funding for NEST. Despite the Minister's assurance at the time that the restrictions on NEST were not integral to the EC's approval, we believed the position regarding state aid had not been clarified beyond doubt during our inquiry. So when we made our recommendation that the contributions cap and the ban on transfers should be lifted, we included the caveat "if state aid rules allow".[26]

26. Figures published by the EC at the time of our previous inquiry indicated that, if NEST experienced low volumes of members, state aid could reach £379 million, whereas, if membership was high, only £200 million might be required.[27] The Minister explained in 2012 that it was not possible to provide a precise figure for the impact the restrictions would have on the level of state aid. However, he accepted that the amount of state aid was likely to be greater than it might otherwise have been as a result of the restrictions being in place and that lifting the restrictions was likely to bring benefits in this respect: "Clearly, there is a benefit to the Exchequer; you lift the constraints on NEST and presumably it gets more contributions and more business, so it can borrow less and repay the loan quicker."[28]

27. The Government has stated that the two restrictions:

> [...] 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.[29]

28. In his most recent oral evidence to us, the Minister highlighted that it was the public service obligation on NEST to accept any employer and employee, "including loss-making customers", that was the key issue in the EC deciding that government funding for NEST did not represent unfair competition. His position was that, although he was not taking EU approval for lifting the restrictions for granted, the proper process was for the UK to decide whether the restrictions should be lifted, based on evidence, and then to make a strong case to the EC. He believed that the EC was "sympathetically disposed to the idea of NEST", in terms of its role in ensuring that people who had previously been excluded from pension provision now had access to a low-cost scheme.[30]

26 Eighth Report, HC (2010-12) 1494, para 175

27 European Commission (2010), *State aid N 158/2009 – United Kingdom, Establishment of the National Employment Savings Trust – NEST*

28 Eighth Report, HC (2010-12) 1494, para 169

29 DWP Consultation on NEST Restrictions, p 13

30 Qs 322 and 325

3 What has changed now automatic enrolment has started?

29. Implementation of automatic enrolment began in October 2012 with the largest employers and will continue through to 2017, gradually bringing in medium, small and micro employers. New employers (those established after April 2012) will be required to begin auto-enrolment from May 2017 through to February 2018.[31]

30. Many witnesses in our current inquiry into pensions governance acknowledged that the existence of NEST in the pensions market had already increased competition, including through new entrants to the market such as NOW: Pensions and the People's Pension, and had encouraged other providers to offer lower charges. It had also prompted improvements in the way in which the pensions industry communicates with its customers.[32] The Minister emphasised a number of times during his oral evidence to us that NEST was bringing positive benefits in terms of raising standards and driving down charges across the pensions industry.[33] However, differences of view persist about whether the restrictions on NEST are supporting or working against the objectives of automatic enrolment.

The case for the restrictions remaining in place until 2017

31. Some representatives of pension companies made a case for the restrictions remaining in place until 2017. Whilst acknowledging that NEST had been established "to deal with a particular market failure, a supply side failure, where we could not supply a solution for automatic enrolment to absolutely everyone", Ronnie Morgan of Scottish Life argued against the restrictions being lifted because he believed that they were necessary to ensure that NEST remained focused on its target market, and to take account of the state funding which NEST received. He highlighted that "we cannot get capital at that kind of rate" and that:

> Doing anything that might discourage people from moving into the automatic enrolment market, or remaining in the automatic enrolment market will just take a lot of skilled people away from being able to deliver the Government's policy, which is getting a million employers actually signed up, implemented and actually getting into a great scheme.[34]

32. Steve Groves of Partnership acknowledged that NEST was "focusing on customers who were not well served by the industry" and that "if the industry wants to compete with that it needs to offer something better". However, he believed that lifting the restrictions should be linked to NEST becoming "self-financing".[35] Richard Parkin of Fidelity highlighted that

31 DWP, *Automatic enrolment into a workplace pension: key facts,* September 2012, p 6

32 See for example CBI (Q 149) ; Towers Watson (Q 220); TUC (Q 248);Age UK (Q 252); Pension Management Institute (Ev w66); The Pensions Advisory Service (Ev 207); TheCityUK (Ev w94)

33 See for example Qs 317, 342 and 357

34 Qs 134-136

35 Q 137

the restriction on transfers would have to be lifted if the Government implemented its proposals for dealing with small pots.[36]

The case for lifting the restrictions now

33. A number of witnesses in our current inquiry agreed that the restrictions were impeding NEST's ability to support automatic enrolment.

34. David Pitt-Watson from the Royal Society for the Encouragement of the Arts (RSA) Tomorrow's Investor programme emphasised that auto-enrolment "is a very good policy, but to make it work [...] we need to make sure that NEST can thrive". At the moment, NEST was "hobbled" by the restrictions.[37] Michael Johnson of the Centre for Policy Studies agreed and argued that the restrictions should be removed.[38] Jane Vass of Age UK told us:

> [...] one reason why there are complex decisions [for employers] is the restrictions on NEST. This was exactly why NEST was set up and we are concerned that some complexity has been increased in the market by having restrictions on NEST's annual contribution limit and also the situation on transfer. We would rather that you actually concentrated on taking pensions out of the "too difficult" box for small employers [...].[39]

The TUC argued that removing the restrictions on NEST would in itself help to "dramatically reduce the frequency and cost of transferring small pension pots".[40] EEF believed that the Government should repeal "the restrictions that risk making NEST, a model of a good scheme for low to modest earners, uncompetitive and unattractive to some employers".[41]

35. Which? wanted to see the restrictions on NEST lifted "as soon as possible". It argued that they have "negative implications for consumers" and that the contribution cap in particular "introduces additional hassle for consumers and employers" and works against simplicity. It also highlighted that "the contributions cap may also unintentionally imply that saving a maximum of £4,400 per year is an appropriate level of saving for adequate retirement provision".[42]

36. In a joint letter to the Minister of 28 January 2013, employers, unions and consumer groups urged the Government to lift the restrictions on NEST because of the "unnecessary administrative headache" they caused for employers. The organisations also argued that the contribution cap prevented employees building up their pensions "particularly in the years running up to retirement when many wish to maximise their savings." The joint letter highlighted that it was necessary to lift the restrictions now, otherwise it would be

36 Q 136

37 Q 3

38 Q 6

39 Q 241

40 Ev 238

41 Ev 146

42 Ev 240

"too late" as employers would already have made their decisions about workplace pension providers.[43]

37. The Minister explained that, before implementation began, the expectation had been that the annual contribution cap would mean that some employers would use NEST for their lower-paid employees and an existing or alternative scheme for other employees. However, this had not happened to the extent that had been predicted: employers who cannot use NEST for their entire workforce are frequently choosing a provider who can cover all their employees in a single scheme because their view is "'We do not want two pension schemes. We only want to have one so we have ruled out NEST from our considerations'".[44] The Minister told us that NEST could cite examples of employers who would have chosen or considered them if the restrictions had not been in place.[45]

38. Another of the obligations that the Government has placed on NEST is a requirement that it should offer good value and have a low-cost objective, but this obligation does not apply to other pension providers.[46] This means that, if employers decide that they cannot opt for NEST because of the restrictions, there is potential for consumer detriment because employees may not then be offered the best value scheme available. The Minister was clear that the test for the Government in deciding whether to lift the restrictions was whether "the NEST constraints are leading to consumers suffering adverse outcomes". The challenge for DWP "is whether consumers who could benefit from NEST, as opposed to another provider, might fail to have access to it because the employer does not choose it because of the constraints".[47]

39. The Minister highlighted that, as auto-enrolment is rolled out to smaller businesses, some employers were likely to face a limited choice of auto-enrolment schemes because of the lack of interest and capacity within the pensions industry. He said "The worry would be that, as we move further down the market, we find that providers are less interested because it is less profitable business". However, the current arrangements mean that "we find that people cannot go to NEST or will not go to NEST because of the constraints". He believed that this might well result in many employees not getting the best value pension which could be achieved from effective competition.[48] He emphasised that the Government would be seeking to act quickly because "we cannot wait for it to go wrong because it is too late by then". That was the reason the Government had launched the consultation: to enable it to gather the necessary evidence for making the change now.[49]

40. Niki Cleal of the Pensions Policy Institute (PPI) made a similar point about the impact on employers: now that auto-enrolment had begun, it was even clearer how the contribution cap was likely to affect smaller businesses. Employers with a small number of

43 Joint letter to the Minster for Pensions, 28 January 2013, from Age UK, the British Chambers of Commerce, EEF-The Manufacturers' Organisation, the Federation of Small Businesses, the TUC and Which?. See TUC Press Release, 28 January 2013, *Employers, Unions and consumer groups call for an end to NEST restrictions.*

44 Qs 323 and 357

45 Q 318

46 DWP Consultation on NEST Restrictions, Executive Summary, para 3

47 Qs 317 and 319

48 Q 317

49 Qs 318 and 322

employees, but on a wide range of earnings, were likely to be deterred from using NEST because they would have to use a second provider for the higher-paid employees, even if there was only one or two of these. As it stood, it would be much simpler for them to use an alternative provider who could cover all the employees, rather than choosing NEST plus another provider. She cited the PPI itself as an example of a small employer in this position:

> PPI is a small business; we have seven employees—we would not want to have two separate pension schemes: NEST for some employees and a separate pension scheme for the higher earners. We would not. If I think about it with my PPI Director hat on, I can totally see how having a contribution limit would preclude us, as a small business, from using [NEST]. [50]

41. The Minister believed that this issue was more likely to affect medium-sized employers (50-249 employees). Small employers were very likely to choose NEST because of the attraction of simplicity and the lack of competition for their business from private providers. He said "we recognise that there is the best part of a million small firms in this country [...] NEST will be the right answer for the vast, vast bulk of them".[51] Medium-sized employers, on the other hand, were more likely to have a choice of providers but would also be more likely to come up against the contributions cap, because they would have employees on a wider range of salaries. This made addressing the issue quickly even more important: employers needed a lead-time of 12 to 18 months to be ready for automatic enrolment and this group of medium-sized employers would be required to begin auto-enrolling from April 2014.[52]

42. The PPI also addressed the issue of whether the restrictions continued to be necessary to ensure that NEST was focused on its target market of low to moderate earners and that pension providers in the private sector were not disadvantaged. Its view was that, although the restrictions may have made sense when NEST was established, "the world has moved on": new entrants offering low-cost pensions had come into the market, such as NOW: Pensions and the People's Pension, which were not subject to the same restrictions as NEST. The issue was no longer about keeping NEST focused on people without access to other pension provision but rather "whether NEST is competing on a level playing field, or is it going to struggle because of these restrictions?"[53]

43. We asked the Minister how long the process would take to lift the restrictions if the Government decided on this course of action. He told us that lifting the restrictions would not require primary legislation and could be done through secondary legislation, by amending regulations, under the affirmative parliamentary process.[54]

50 Q 37

51 Qs 324 and 372

52 Q 318; see also DWP, *Automatic Enrolment into a workplace pension: key facts, September 2012,* p 6

53 Q 37

54 Qs 320-321

4 Conclusion: the NEST restrictions should be lifted now

44. **Representatives of the pensions industry argue that the restrictions need to remain in place to keep NEST focused on its target market of low-earners and people who previously had no access to a workplace pension. The majority of private pension companies have made clear that they are unlikely to be interested in offering pension schemes to these groups. Our view is that NEST's public service obligation, to be available to all employers who wish to use the scheme to meet their auto-enrolment requirements, and to accept all individuals automatically enrolled into it, already ensures that NEST will retain this focus. The pensions industry's concerns therefore appear to us to have little foundation. We see no justification for continuing to inhibit NEST by persisting with these restrictions, which risk preventing NEST from using taxpayers' money most effectively and which disadvantage employers and employees.**

45. **When we made our original recommendation for lifting the restrictions, we highlighted that the Government needed to satisfy itself that this would not conflict with the undertakings it had given to the European Commission on state aid for the establishment of NEST. It is important that the Government now makes it a priority to gain certainty on the state aid issue, to ensure that this is no longer perceived to be an obstacle to removing the restrictions. The Minister's position is that it is the Government's responsibility to gather the evidence for lifting the restrictions, through its consultation, so that it can then make a strong case to the EC. We agree with this approach.**

46. ***Our 2012 report on automatic enrolment and NEST made a strong recommendation for the two key restrictions on NEST to be lifted as a matter of urgency. The case for taking this action has become even more powerful since implementation of auto-enrolment began in October 2012. There are very positive signs, in that new providers have entered the market and the first round of auto-enrolment has proceeded without market failure. Nevertheless, it is clear that the annual contributions cap is adding complexity for employers and employees as we predicted it would. The ban on transfers is preventing the consolidation of small pension pots, and the Government has made clear that it will need to "fix this" in order to proceed with its "pot follows member" solution to the small pots problem. We therefore reiterate our previous recommendation that these two restrictions on NEST be lifted now, rather than waiting for the 2017 review. We believe this is necessary to support the continued success of automatic enrolment implementation.***

47. ***The Government estimates that it takes employers between a year and 18 months to prepare for enrolling their employers into a pension scheme under the auto-enrolment requirements. Medium and small employers need clarity now about the services NEST will be able to offer, given that the requirement to auto-enrol begins for them from April 2014. Lifting the restrictions will not require primary legislation: it can be achieved through secondary legislation. While this is reassuring to some extent in terms of the length of time needed to implement the change, it is important that the Government publishes the response to its consultation and makes the decision to remove the***

constraints on NEST in the next few months, to give employers the certainty they need. We recommend that the amending legislation is then introduced as a matter of urgency.

Formal Minutes

Wednesday 6 February 2013

Members present:

Jane Ellison
Graham Evans
Sheila Gilmore
Glenda Jackson
Stephen Lloyd
Nigel Mills
Anne Marie Morris
Teresa Pearce

In the absence of the Chair, Stephen Lloyd was called to the chair.

Draft Report (*Lifting the Restrictions on NEST*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 47 read and agreed to.

Summary agreed to.

Resolved, That the Report be the Fourth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 13 February at 9.15 am.

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2010–12

First Report	Youth Unemployment and the Future Jobs Fund	HC 472 *(HC 844)*
Second Report	Changes to Housing Benefit announced in the June 2010 Budget	HC 469 *(HC 845)*
Third Report	Appointment of the Chair of the Social Security Advisory Committee	HC 904
Fourth Report	Work Programme: providers and contracting arrangements	HC 718 *(HC 1438)*
Fifth Report	The Government's proposed child maintenance reforms	HC 1047 *(HC 1727)*
Sixth Report	The role of incapacity benefit reassessment in helping claimants into employment	HC 1015 *(HC 1641)*
Seventh Report	Government support towards the additional living cost of working-age disabled people	HC 1493 *(HC (12– 13)105)*
Eighth Report	Automatic enrolment in workplace pensions and the National Employment Savings Trust	HC 1494 *(HC (12–13)154)*

Session 2012–13

First Report	Appointment of the Chair of the Social Security Advisory Committee	HC 297
Second Report	Youth Unemployment and the Youth Contract	HC 151 *(HC 844)*
Third Report	Universal Credit implementation: meeting the needs of vulnerable claimants	HC 576 *(Cm 8537)*