National Employment Savings Trust (NEST) - background

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The Pensions Commission, in its Second Report, published in November 2005 recommended two key elements of reform to the UK pensions system. One was reform of the state pension system to make it "less means-tested and closer to universal" than if the existing indexation arrangements continued indefinitely. The other was the creation of:

> A low cost, national funded pension saving scheme into which individuals will be automatically enrolled but with the right to opt out, with a modest level of compulsory matching employer contributions, and delivering the opportunity to save for a pension at a low Annual Management Charge.

The Labour Government, in its May 2006 Pensions White Paper, adopted the Commission's proposed approach of an integrated package of reforms: a new pension saving scheme, along the lines of the Commission's proposed National Pension Savings Scheme, and reform of the state system with the aim of "providing a foundation for private saving."

The first part of this package of reforms was provided for in the P*ensions Act 2007.* This provided for reforms to the state system and established a Personal Accounts Delivery Authority (PADA) to enable the Government to harness private sector expertise in preparatory work for the new scheme. A subsequent piece of legislation – the *Pensions Act 2008* - legislated for the introduction of new duties on employers to automatically enrol jobholders into, and to contribute to, a qualifying workplace pension scheme and the introduction of a new pension saving scheme – initially called "personal accounts", now called the National Employment Savings Trust (NEST).

The Conservative Liberal Democrat Coalition Government set up a review of the proposed arrangements for automatic enrolment and NEST. The review, which reported in October, found that NEST was necessary to support successful implementation of automatic enrolment.

This note looks at the background to and development of NEST. A further note – [SN 6415 National Employment Savings Trust (NEST), 2012 onwards] - takes the story forward.

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1 Development of proposals for NEST

1.1 Terminology

Different terms have been used in the course of the development of these proposals. The Pensions Commission used the term "National Pension Savings Scheme." The term initially used by Labour Government, when it originally announced its own proposals, was "personal accounts." In January 2010, it announced that the permanent name for the scheme would be the National Employment Savings Trust (NEST).

1.2 The Pensions Commission

Analysis

The Labour Government established the Pensions Commission in December 2002 in response to growing concern that people were not saving enough for their retirement and that measures taken to encourage private sector provision were not succeeding. Its remit was:

> To keep under review the regime for UK private pensions and long-term savings, and to make recommendations to the Secretary of State for Work and Pensions on whether there is a case for moving beyond the current voluntarist approach.[1]

The members of the Pensions Commission were Lord Turner of Ecchinswell (chair), Jeannie Drake and John Hills.[2]

Its first report, *Pensions: Challenges and Choices*, published on 12 October 2004, said:

> Faced with the increasing proportion of the population aged over 65, society and individuals must choose between four options. Either:
>
> (i) pensioners will become poorer relative to the rest of society; or
>
> (ii) taxes/National Insurance contributions devoted to pensions must rise; or
>
> (iii) savings must rise; or
>
> (iv) average retirement ages must rise.
>
> But the first option (poorer pensioners) appears unattractive; and there are significant barriers to solving the problem through any one of the other three options alone. Some mix of higher taxes/National Insurance contributions, higher savings and later average retirement is required.[3]

Its second report, published on 30 November 2005, explained that over the intervening year, the Commission had extended and deepened its analysis, with the following key conclusions:

> i. The current system of private funded pensions combined with the current state system will deliver increasingly inadequate and unequal results….

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1 Pensions Commission, *Pensions challenges and choices. The first report of the Pensions Commission*, October 2004, pix

2 Ibid, pvii. At the time the Pensions Commission was established, Adair Turner was Vice Chair of Merrill Lynch Europe, a director of United Business Media plc and chair of the UK Low Pay Commission. Jeannie Drake was Deputy General Secretary of the Communication Worker's Union and President of the TUC. John Hill was Professor of Social Policy and Director of the ESRC Research Centre for Centre for Analysis of Social Exclusion at the London School of Economics.

3 Ibid, Executive Summary

ii. These problems are not solvable through changes to the state system alone, nor with incremental measures to encourage voluntary provision. But attitudes to compulsion are ambivalent…..

iii. Savings through house purchase and inheritance of housing assets will make a significant contribution to pension adequacy for many people, but housing cannot be considered a sufficient response to pension adequacy….

iv. Long-term pension policy needs to be robust in the face of rising life expectancy and of major uncertainty about the pace of that increase…..

v. Analysis of pension systems and pension reforms in other countries suggests two major ideas of potential relevance to the UK:

The potential to reduce costs via a system of nationally administered individual accounts.

The potential to apply automatic enrolment to pension saving schemes nationally as well as at individual employer level.[4]

The Commission concluded that a previous Government initiative to increase participation in pension saving (Stakeholder Pensions – introduced in April 2001) had failed:

A primary policy initiative that focused on increasing participation, the Stakeholder Pension, while achieving some reduction in costs, has not achieved any measurable increase in participation. Eighty per cent of all employer designated Stakeholder schemes are "empty shells": nominated schemes but with no members. [5]

It recommended two key elements of reform:

- The creation of a low cost, national funded pension savings scheme into which individuals will be automatically enrolled, but with the right to opt out, with a modest level of compulsory matching employer contributions, and delivering the opportunity to save for a pension at a low Annual Management Charge.

- Reforms to make the state system less means-tested and closer to universal than it would be if current indexation arrangements were continued indefinitely. In order to achieve this while maintaining the standard of living of the poorest pensioners it will need to be more generous on average. In the long-term this implies some mix of both an increase in taxes devoted to pensions expenditure and an increase in State Pension Ages.[6]

Proposal for a National Pensions Savings Scheme

The Pensions Commission proposed the creation of a National Pension Savings Scheme (NPSS), which would apply the principle of automatic enrolment at a national level with a compulsory employer contribution:

All employees not covered by other adequate pension arrangements should be automatically enrolled into the scheme but with the right to opt-out. A modest level of

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[4] Pensions Commission, *A new pensions settlement for the twenty first century. The second report of the Pensions Commission,* November 2005; p 2-4

[5] Ibid, p48

[6] Ibid, p6

> matching contribution by employers should be compulsory. The self-employed should be able to participate on a voluntary but cost-effective basis.[7]

Charges were to be kept low through the use of a national payment collection system and the option of investment in very low cost funds which would be bulk bought:

> **Ensuring low cost of operations**
> The scheme should aim to deliver to all employees and the self-employed the opportunity to save for a pension at the Annual Management Charge (e.g. 0.3% per year or less) today enjoyed only by employees of large firms, by public sector employees or by high income individuals. To achieve this, the National Pension Savings Scheme will have to:
>
> - Use a national payment collection system, such as Pay As You Earn (PAYE) or a newly created Pension Payment System, to collect contributions in a cost-effective fashion and in a fashion which imposes minimal administrative burdens on business.
>
> - Provide members with the option of investment in very low cost funds bulk bought from the fund management industry.[8]

Employers already providing more generous contributions than the proposed minimum for the NPSS would be allowed to opt out and automatically enrol employees into alternative arrangements:

> **Encouraging the maintenance of existing high quality pension provision**
> Where employers already provide more generous contributions than those defined as the default within the scheme, procedures will be required to allow them to opt-out from the national scheme and automatically to enrol employees into these alternative arrangements.[9]

The level of minimum contributions was to be set at 8% of a band of earnings above the "Primary Threshold" (the level at which income tax and national insurance become payable). This was to be made up of 4% of a band of the employee's post-tax earnings, 1% from tax relief and 3% from matching compulsory employer contributions. Voluntary contributions above this level would be allowed, subject to a cap. The Pensions Commission's analysis was that contributions at this level could deliver a "baseload of earnings replacement":

> On reasonable assumptions about rates of return and years of contribution this might secure the median earner a pension at the point of retirement of about 15% of median earnings on top of the 30% which state provision will deliver under our proposals. Many will want to secure a higher level of pension replacement. We therefore also recommend that voluntary contributions on top of the default level should be allowed, subject to a cap: for the median earner this would enable the individual and/or their employer to contribute in total about twice the default amount, accumulating a pension pot which would take them to a total combined replacement rate approaching the two-thirds that many say is their target.[10]

The Pensions Commission estimated that the NPSS would play a significant role in offsetting the decline in private pension income which would otherwise occur. However, its success in achieving high participation and adequate contribution rates would need to be kept under review:

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7 Ibid, p7-8
8 Ibid
9 Ibid
10 Ibid

> We estimate that under reasonable assumptions on participation rates, contribution rates and rates of return, the NPSS will play a significant role in offsetting the decline in private pension income which will otherwise occur, contributing an additional 0.7% of GDP to pensioner incomes by 2050, and about 1.2% by 2070. The success of the NPSS in achieving high participation and adequate contribution rates should however be kept under constant review to identify whether changes are required to achieve the objectives.[11]

1.3 Pensions White Paper, May 2006

The Government published its White Paper, *Security in retirement: towards a new pensions system* (the 'Pensions White Paper') in May 2006. The Government adopted the Pensions Commission's approach of an integrated package of reforms: a system of personal accounts (along the lines of the Commission's proposed National Pension Savings Scheme) and reform of the state pension with the aim of "providing a foundation for private saving":

> 34. Having assessed the recommendations of the Pensions Commission, we will:
>
> - Introduce low-cost personal accounts to give those without access to occupational pension schemes the opportunity to save. People will be automatically enrolled into either their employer's scheme or a new personal account, with the freedom to opt out. Employers will make minimum matching contributions.
> - Improve the foundation for all while continuing to tackle pensioner poverty. We will reform the state pension system by uprating both the guarantee element of Pension Credit and the basic State Pension in line with earnings growth, rather than prices. We will make the State Pension fairer and more widely available and we will raise the State Pension age in line with increasing longevity.
>
> The reforms set out here will make an immediate difference to those working and saving for retirement, striking a new balance of responsibility between employer, State and individual. At the same time, we will continue to protect the poorest pensioners from poverty, and we will ensure that all pensioners share in rising prosperity.[12]

1.4 Personal Accounts White Paper

The Government published its Personal Accounts White Paper in December 2006. This set out further details of the proposed approach and set a number of questions for consultation on issues such as: the way in which automatic enrolment would work; how members' interests should be represented; the appropriate charging method; the phasing in of the new duties for employers; and the contribution limits that should apply.[13] The Government's response to the consultation was published in June 2007.[14]

Work and Pensions Committee Report

The Work and Pensions Committee's report on *Personal Accounts,* published in March 2007, welcomed the proposal for a new system of personal accounts, but said there was a "lot of work to do to ensure" it worked well in practice:

> We conclude that the Government must focus on keeping the system as simple as possible for employers and employees, and on ensuring that charges to the consumer

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[11] Ibid

[12] Ibid, p15

[13] DWP, *Personal accounts: a new way to save*, Cm 6975, December 2006

[14] *'Personal Accounts: a new way to save, Summary of responses to the consultation'* 14 June 2007

> are low. We also recommend that the Personal Accounts Board should closely monitor the numbers of people opting out in different sections of the target market once the scheme is in place. [15]

With those principles in mind it made a series of recommendations, for example, regarding the collection system, the choice of funds, the interaction with means-tested benefits in retirement, the provision of information and advice and the need to encourage saving before implementation of the personal accounts scheme in 2012. The Government published its response to the Committee alongside its response to the consultation, in June 2007.[16]

1.5 Debate in Parliament

The principles of automatic enrolment into a low cost pension saving scheme attracted broad support when the legislation was before Parliament. At the Bill's Second Reading on 7 January 2008, the then Shadow Secretary of State for Work and Pensions, Chris Grayling, said the principle underlying the reforms in the Bill "should and does command support throughout the House."[17] However, he was concerned that if the issue of means-testing and automatic enrolment was not addressed, the reforms would be "launched with a huge hole below the waterline." The problem was, he said, that some people who would be automatically enrolled would derive no benefit from pension saving because they would "not be able to save enough money to provide them with a pension income that is greater than they would have received anyway from means-tested benefits."[18] Other issues of concern included whether the introduction of personal accounts would result in a "levelling down" of employer contributions, whether people would be able to make lump sum contributions to personal accounts;[19] and the roles to be played by the bodies responsible for setting up and running the scheme.

The then Liberal Democrat Shadow Secretary of State for Work and Pensions Danny Alexander welcomed aspects of the Bill - automatic enrolment, compulsory employer contributions and low charges for personal accounts – but called for two issues, in particular, to be addressed:

> We want the Bill to work, but for that to happen some serious and important problems need to be debated and resolved. We believe that the important two related issues are the interaction of means-testing and how advice will be dispensed and dispersed.[20]

1.6 Legislation

The *Pensions Act 2007* established a Personal Accounts Delivery Authority (PADA) to enable the Government to harness private sector expertise in the preparatory work for the new national pension saving scheme (at that stage referred to as "personal accounts").[21]

A second piece of legislation - *Pensions Act 2008* – provided for the introduction of new employer duties on employers to automatically enrol jobholders into, and to contribute to, a

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[15] Work and Pensions Committee, *Personal Accounts,* Fifth Report of Session 2006-07, HC 220-I; Summary

[16] 'Report on Personal Accounts. Government response to the Fifth Report of the Work and Pensions Select Committee, Session 2006–07 [HC 220-1], June 2007, Cm 7122

[17] HC Deb, 7 January 2008, c71

[18] Ibid, c74

[19] Ibid, c78-9

[20] Ibid, c83

[21] *Pensions Act 2007*, s20-23 and Schedule 6

qualifying workplace pension scheme. It also provided for the establishment of the NEST scheme.[22]

Since Royal Assent, statutory instruments have been issued providing for more detail. These are referred to below where relevant.

1.7 Coalition Government review of NEST

In a paper published in early 2010, the then Shadow Work and Pensions Secretary, Theresa May, said the Conservative Party had concerns about the way things were shaping up:

> Conservatives also support the motives behind Personal Accounts: ensuring that low and middle earners are saving for the future with contributions from their employer. However, there are clear concerns about the way things are shaping up. We have long-standing concerns about the potential for employers to level down their contributions as well as the administrative costs involved and the ability of government to deliver another large-scale IT project.[23]

She was also concerned that, following a review of the timetable by the Labour Government, the roll-out of new employer duties would be slower than originally intended. She said a future Conservative government would review the NEST project:

> Such a slow start could undermine the credibility of the whole project and leave millions of people facing a gap in contributions that they might never make up. Not only will this not lead to improved levels of savings; it could actually reduce savings rates at the very time we need them to be increasing.
>
> As a result, after the next election any new government will need to review the Personal Accounts/NEST project, and I can confirm that a Conservative government would do that.[24]

The Conservative Liberal Democrat Coalition Government said at the end of May that it would set up a review to look at the scope of auto-enrolment and the delivery model for NEST.[25] The terms of reference for the review were announced on 24 June 2010. The review would take account of developments since the Turner recommendations were formulated, including:

- The credit crunch in financial markets, the economic downturn and the fiscal deficit;
- A greater understanding of likely costs and the proposed charging structure for NEST;
- The proposed approach and profile for introducing the new employer duties and phasing in of minimum levels of mandatory contributions;
- The proposed review of state pension age; and
- Other changes such as the further increases in life expectancy and further decline in private sector pension coverage.

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[22] Part 1, chapters 5 and 6
[23] Theresa May, *Providing for Pensions. Principles and Practice for Success*, Politeia, (2010)
[24] Ibid
[25] Nicholas Timmins, 'Pension plans for lower paid staff in review', *Financial Times,* 28 May 2010

The review would consider whether the proposed scope for automatic enrolment was still appropriate.[26] It would also look at the "availability and capacity of pension providers other than NEST to service the potential automatically enrolled population" and at whether "the policy of establishing NEST, as currently envisaged, is the most effective way to deliver future access to workplace pension saving and income security in retirement." In reaching its conclusions, the review would have regard to the effectiveness of the proposed regime in:

> a. Tackling pensioner poverty as quickly as possible, including among women pensioners;
>
> b. Maximising voluntary private savings and the speed by which this objective can be achieved;
>
> c. Minimising the administrative burdens on employers and the impact on existing provision;
>
> d. Achieving an effective balance between the achievement of policy objectives, pace of implementation, value for money and risk; and
>
> e. Maximising value for money for the Exchequer. [27]

The review was conducted by an independent team, led by Paul Johnson, Frontier Economics, David Yeandle OBE, Engineering Employers Federation and Adrian Boulding, Legal and General Group plc.[28] In its report to DWP, published on 27 October 2010, the review team concluded that NEST was necessary to support successful implementation of automatic enrolment:

> Automatic enrolment requires that all employers are able to find a pension scheme into which they can enrol their employees. Providers are currently unable to profitably service many employers, particularly small ones. Whilst we would be naturally cautious of recommending such a major intervention into the market, with a Government loan, as NEST, we see no alternative if automatic enrolment is to be introduced at anything like the currently envisaged scope on anything like the currently envisaged timescale.
>
> Whilst some of those we consulted felt that the market might eventually design ways of providing pensions profitably to small employers and those with low earnings, none was confident this could be done in the short term. Many were sceptical it would even be possible over a longer timescale. Both our discussions with senior industry figures and modelling carried out at DWP suggest to us that only with a dramatic reduction of scope could automatic enrolment proceed without NEST. Whilst it is hard to be precise, we would only be confident that NEST was not needed were employers with fewer than 20 employees and employees earning less than £14,000 a year excluded from scope.[29]

The review also made recommendations on the policy on transfers and the annual cap on contributions (see section 2 below).

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[26] This is discussed in more detail in Library Note Pensions: Automatic enrolment – 2010 onwards

[27] DWP, *Making automatic enrolment work: terms of reference*, 24 June 2010

[28] HC Deb, 24 June 2010, c21-2WS *Finance (No 2) Bill 2010/11* – Explanatory Notes (clause 30)

[29] 'Paul Johnson, David Yeandle and Adrian Boulding, 'Making automatic enrolment work. A review for the Department for Work and Pensions', 27 October 2010, p7

Pensions Minister, Steve Webb, described the recommendations as "a sensible and balanced package of proposals." The Government would "now proceed with implementation of the reforms on this basis."[30]

2 Issues

2.1 Delivery model

An intense subject of debate, following the publication of the Pensions Commission's Second Report, was the design of the proposed National Pension Savings Scheme (NPSS). In the model proposed by the Pensions Commission, individuals would be able to choose the asset class in which their fund was invested. However, neither individual nor employer would choose between providers of account administration services. This choice would be made by the NPSS.[31] This model had the support of organisations such as *Which?,* the Investment Management Association (IMA) and the TUC. The TUC, for example, said:

> It is clear that costs will be a central issue for any model of the NPSS. We believe it is equally clear that the supporting model proposed by the Commission is the most likely way to minimise costs for scheme members.[32]

However, alternative models were proposed by the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF). The ABI supported the Pensions Commission's view that pension costs could be substantially reduced and saving increased though "auto-enrolment; compulsory employer contributions; reduced regulatory costs; and reforms to means-testing."[33] However, it did not agree with the proposed NPSS model:

> 2. However, we do not agree with the Pensions Commission that it is necessary to set up an entirely new, state-sponsored, pension organisation. Such an approach would simply expose the taxpayer to high set-up costs and the financial risks associated with major Government IT projects.
>
> 3. Instead, the Government should make use of the insurance industry's proven experience and IT infrastructure. This approach - Partnership Pensions - would:
>
> - deliver the Pensions Commission's goal of low-cost "personal account" pensions by using auto-enrolment and compulsory employer contributions;
>
> - harness competition to increase participation rates and saving levels, improve service and exert downward pressure on charges;
>
> - offer choice, for those who want it, and a good "no choice" default option for those who do not;
>
> - protect good existing workplace pensions and the broader pensions market;
>
> - operate at a charge level at, or only slightly higher, than those actually likely under the Pensions Commission's proposals; and,

[30] HC Deb, 27 October 2010, c12WS

[31] Pensions Commission, '*Implementing an integrated package of pension reforms. The final report of the Pensions Commission*', April 2006, p28

[32] Treasury Committee, *The design of the National Pension Savings Scheme and the role of financial services regulation*, 18 May 2006, HC 1074-II, Ev87, 2005-06; See also Ev 91 [which?]

[33] Ibid, Ev104

- be up and running far more quickly than a state-sponsored scheme.[34]

NAPF proposed a system built on "Super Trusts" – large scale, multi-employer defined contribution schemes. This, it said:

> would achieve the same low cost and coverage as the proposed National Pensions Saving Scheme (NPSS) but without the disadvantages of posing significant risk to Government and presenting consumers with difficult (and unwanted) investment decisions. [35]

The Pensions Commission's final report (published in April 2006) responded to the arguments that had been put forward regarding the design of the NPSS and evaluated the alternative models that had been proposed. All models included automatic enrolment, with the right to opt out. The key difference between the models, in its view, related to "whether there is choice and who exercises choice, both as regards asset class selection and as regards the provider of account administration services."[36] The Commission assessed the NPSS and the models proposed by the ABI and NAPF against four criteria:

- Regarding cost and customer value, it concluded that the NPSS model was most likely, "in the long run to deliver the most favourable combination of low cost and member benefits."[37]
- It acknowledged that there were significant set-up risks in the establishment of an NPSS, but considered that these would not be eliminated by outsourcing operations. In addition, there was an important trade off to be made with the "likely long-term cost benefits of a single NPSS approach".[38]
- Regarding return risks and governance, it considered the risks to government might be higher in a multi-provider model, particularly when individuals did not make their own choice of provider. If individuals were allocated to a provider on a carousel basis, they could "at least retrospectively claim that they had been encouraged to save and automatically assigned to funds which had performed relatively poorly."[39]
- While there had been criticism that the NPSS proposal might encourage "levelling down" from existing provision, the Pensions Commission did not think this risk would be eliminated by the alternative models proposed. The key defence against levelling down was to convince employers and employees that contributions to a pension were a desirable form of remuneration.[40]

In its May 2006 Pensions White Paper, the Labour Government said it would conduct further analysis regarding the delivery model (i.e. whether there should be a national scheme or competition between branded providers) in order to strike the right balance between value for money for the taxpayer and value for money for the saver.[41] The vast majority of respondents who mentioned personal accounts "welcomed the idea of a low-cost, portable personal account scheme".[42] The December 2006 Personal Accounts White Paper, explained

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[34] Ibid Ev 104
[35] Ibid, Ev 49
[36] Pensions Commission, *The final report of the Pensions Commission*, April 2006, p28
[37] Ibid, p35
[38] Ibid, p35
[39] Ibid, p36
[40] Ibid, p39
[41] DWP, Security in retirement: towards a new pensions system, Cm 6841, May 2006, p16
[42] DWP, Security in retirement: towards a new pensions system. Summary of responses to the consultation, October 2006, p32

that the Government had decided to adopt the "NPSS approach for personal accounts but with a choice of funds for those who wanted it":

> 37. Personal accounts are intended to solve the problems of low portability and high charges. They will do this by operating as a large, multi-employer occupational pension scheme and extending the benefits of employer schemes to those currently without access to them.
>
> 38. The large scale of personal accounts means that the set-up costs can be spread over a longer period and recovered from higher funds under management, thus reducing the average charge. This large scale will allow personal accounts to achieve economies of scale similar to those of large occupational schemes. However, unlike many employer schemes, individuals will be able to keep their account as they change jobs and continue to make contributions.[43]

In early 2010, the then Shadow Work and Pensions Secretary, Theresa May, expressed concerns about the administrative costs involved in the scheme and the "ability of government to deliver another large-scale IT project."[44]

On 24 June, the Coalition Government announced the terms of reference of its review of workplace pension reforms, including the question of "the availability and capacity of pension providers other than NEST to serve the potential automatically enrolled population."[45]

Consumer groups[46] wrote to the Secretary of State expressing support for the NEST model:

> At the heart of the consensus is the principle of auto-enrolment. It spanned not just the political parties but consumer, employer and industry bodies too. We very much welcome Lord Freud's strong support for auto-enrolment in the recent House of Lords debate.
>
> But auto-enrolment can only work if at least one pension scheme has a public service duty to accept every employer even if they would not make a good business proposition for a commercial provider.
>
> There is consistent clear evidence of market failure in the provision of pensions to those earning median earnings or below, who rarely have access to simple low-cost pensions that reflect their distinct needs and preferences. It is even more important for middle and low income employees that pensions are provided on a low-cost basis so that members can benefit from economies of scale. Nor should we forget the interests of the self-employed who have little or no access to pension schemes with low charges.In other words if NEST did not exist, then it would need to be re-invented to make auto-enrolment work.[47]

The team set up by the Government to look at "*Making automatic enrolment work*" concluded that NEST was essential to the success of the reforms:

> Starting from a proposition of wanting to provide relatively low-cost pension provision for individuals without very significant reductions in the scope of coverage of automatic enrolment, our profitability analysis supports the Pensions Commission's argument that

[43] DWP, *Personal accounts: a new way to save*, Cm 6975, December 2006

[44] Theresa May, *Providing for Pensions. Principles and Practice for Success*, Politeia, (2010)

[45] DWP, *Making automatic enrolment work: terms of reference*, 24 June 2010

[46] Financial Services Authority Consumer Panel, Teresa Perchard, Citizens Advice, Nigel Stanley, TUC, Doug Taylor, Which?, Jane Vass, Age UK

[47] TUC Press Release, *Consumers warn ministers over 2012 pension review*, 22 June 2010

there is a supply gap in the existing pensions market. This gap persists despite the introduction of automatic enrolment; in fact, automatic enrolment counter-intuitively decreases overall profitability in the market, due to the inclusion of new savers with low salaries, low contribution levels and relatively high job churn.

We conclude that it would be wrong to ask the existing pensions industry to cover the hole of the automatic enrolment population, either through higher charges or through some form of subsidised charges. A significant risk in asking the pensions industry to cover a new and, at current charge levels, unprofitable client group would be substantively higher charges. These would impact both on new savers and potentially lead to higher costs in the wider market place. This would undermine the hard won gains in terms of value for money that we have seen over the last ten years.

By contrast, we believe that the introduction of NEST will both offer good value to its target audience and provide a high benchmark for the rest of the pensions industry. We hope that, in many areas, existing pension providers will raise their game to meet this competition, providing further improvements in value for money for those being enrolled into pension saving.

The Pensions Commission set out the basic choice the nation faces: save more or work longer or pay higher taxes. They saw the "save more" option as critical to ensure the large "baby boomer" generation save now for their own retirement, rather than asking the smaller generations that follow to pay for them through taxation. Probably inevitably, the programme has already taken longer to implement than the Pensions Commission envisaged, but to delay it further, maybe by up to another three years, while alternative models are investigated and built, would be to undermine seriously the basic concept of "save more".

Mindful of the need to make progress, we reject alternative proposals that would add a number of years to the timetable and which do not have the strong certainty of delivery that NEST has built up to date. We conclude that NEST is a necessary part of ensuring universal access to a pension scheme at acceptable cost to the member. This view is also held by the majority of stakeholders who responded to our consultation during the review. Consumer and employer groups see NEST as a necessary and integral part of the reforms, and even industry representatives do not feel that that they can – or would wish to – provide a workable alternative to NEST.

We believe that NEST will be a force for good, setting high standards for the UK's pension provision, and working with the pension industry to improve customer outcomes.[48]

Tata Consultancy Services (TCS) was awarded the contract on 2 March 2010, following a 14 month procurement exercise.[49] The *Financial Times* reported on 28 May 2010 that the contract might be looked at again.[50]

2.2 Risk of "levelling down"

A concern raised in consultation on the reform proposals and in debates in Parliament was whether the package of reforms - the duty on employers to automatically enrol employees into and contribute to a qualifying pension scheme and the new system of personal accounts - would result in a "levelling down" of existing provision. For example, there was a concern

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[48] Paul Johnson, David Yeandle and Adrian Boulding, 'Making automatic enrolment work. A review for the Department for Work and Pensions', 27 October 2010, p93-4

[49] DWP Press Release, 16 March 2010, 'New low cost pensions to help millions to save for retirement'

[50] Nicholas Timmins, 'Pension plans for lower paid staff in review', *Financial Times,* 28 May 2010

that employers already contributing to their employees' pensions might reduce their contributions to the minimum required under the new rules.

The Pensions Commission, in its final report, acknowledged that a risk of "levelling down" existed but argued that this could not justify rejecting automatic enrolment or the minimum matching employer contribution. The priority should be to increase pension saving among those who had no private pension provision:

> One criticism which has been made of the NPSS proposal is that it might encourage "levelling down" from existing pension provision, i.e. that companies faced with the need to automatically enrol employees either into their own existing scheme or into the NPSS and faced with a defined national minimum contribution will reduce employer contribution rates. Since average employer contribution rates to DC schemes are presently about 6%, this risk clearly exists…
>
> The risk of levelling down cannot however justify rejecting automatic enrolment, nor justify rejecting a minimum matching employer contribution. As Figure 3 showed, an estimated 56% of the private sector workforce including the self-employed now has no occupational or personal pension provision to supplement state provision, and this proportion is growing, up from 51% in 2002/03, and 44% in 1996/97. With state pension provision becoming increasingly flat-rate and, even under the Pensions Commission's proposals, becoming on average less generous, the priority must be to increase funded pension saving among those who have no private pension provision, even if this increases somewhat the danger of levelling down for the minority who already enjoy some private provision.
>
> Moreover if the risk of levelling down to the NPSS minimum is severe, there must be a significant danger that employer pension provision will in any case decline, since the danger of levelling down implies that many employers are currently including higher employer pension contributions in their total remuneration packages with no confidence that these are playing an economically efficient role in recruiting and retaining people of appropriate skills. Indeed in the absence of an NPSS minimum this levelling down could be to a floor of 0% rather than 3%. The most reasonable judgement may be that without an NPSS, this "levelling down to zero" effect would occur in many small and medium companies, but that whether or not the NPSS were implemented many large companies would continue to provide pension contributions significantly above NPSS minimum standards. This would be because they see such pension provision as both tax-efficient remuneration and essential to their positioning in the labour market.[51]

The Labour Government also acknowledged that such a risk existed. It said it had taken measures to mitigate the risk:

> 2.107 The Government recognises this risk and is therefore taking a number of measures to mitigate it, including a deferral period for employers offering higher contributions and simple qualifying tests for existing schemes. It is also taking measures to ensure that the personal accounts scheme is targeted at the part of the market not well-served by existing schemes, for example by setting an annual contribution limit. These reforms should also be viewed against a long-term trend of employers retreating from workplace pension provision where there is currently no minimum entitlement. [52]

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[51] Pensions Commission, *The final report of the Pensions Commission*, April 2006. p37-8

[52] DWP, *Pensions Bill – Impact Assessment*, 5 December 2007, para 2.107-8

It said it would continue to review the evidence on levelling down and to monitor trends amongst employers and within the pensions industry as 2012 approached.[53]

The Pensions Policy Institute (PPI) published a report in November 2007, looking at whether personal accounts would increase pension saving.[54] PPI said it was important to collect further evidence on the likely response of employers:

> The UK will be only the second country after New Zealand to introduce anational system of auto-enrolment with the right for individuals to opt out. It is difficult to predict how many people will want to opt out of pension saving but it is likely that there will be at least 4 million, and up to as many as 9 million, new people saving in a work-based pension scheme when the reforms are introduced in 2012."
>
> Even though the number of people saving in a pension is likely to increase substantially, there may, or may not, be a significant increase in the total amount saved in private pensions. This depends on how employers with existing pension schemes respond to the additional costs that they may face due to automatic enrolment. "
>
> Some employers have said that they will close their existing schemes or reduce their pension contributions as a result of the reforms. If employers act in line with a survey of their likely responses, the reforms could increase annual total pension contributions by around £10 billion initially, but this could be only around £2.5bn above the level without reform by 2050.
>
> "Given the significant impact that employer and employee behaviour will have on the outcome of the Government's private pension reforms, it is important to collect further evidence on their likely responses.[55]

Concerns about the potential for leveling down were raised by Opposition parties on a number of occasions in debate in Parliament.[56]

Analysis by the Department for Work and Pensions (DWP) showed that that of the 1.3 million employers in the private and not-for-profit sectors, more than a million would be expected to start contributing for the first time or to increase existing contributions up to the minimum three per cent:

> Approximately 750,000 employers offer no workplace pension provision;
>
> Approximately 280 employers offer some provision but make less than a 3 per cent employer contribution; and
>
> Approximately 270,000 employers offer a contribution greater than 3 per cent.[57]

It was estimated that the policy of automatic enrolment and mandatory contributions from individuals and employers would generate pension savings of up to approximately £9 billion a year by 2020 (of which some 50 to 70 per cent were expected to represent additional household saving).[58]

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[53] Ibid

[54] PPI, *Will Personal Accounts Increase Pension Saving*, Briefing Note No. 42, November 2007

[55] Pensions Policy Institute Press Release, 22 November 2007, 'PPI publishes new analysis of how Personal Accounts could impact UK pension savings'

[56] See, for example, Pensions Bill Deb, 29 January 2008, c241-252 [Nigel Waterson and Paul Rowen]; HC Deb, 22 April 2008, 1229 [Nigel Waterson].

[57] DWP, *Workplace Pension Reform Regulations Impact Assessment,* 12 January 2010, para 4.6

[58] Ibid, para 2.3 to 2.4

DWP found that most employers were supportive of the reforms (although that awareness and support was generally stronger amongst larger firms). However, 37 per cent believed the reforms were a bad idea. The attitude of small employers was very much linked to the economic situation of the time.[59]

In early 2010, the then Shadow Work and Pensions Secretary, Theresa May, said the Conservative Party had long-standing concern about the potential for employers to level down their contributions.[60]

2.3 The target group

The Work and Pensions Committee recommended that the Government "clarify its definition of the personal accounts target market in terms of categories of people and income levels." It argued that a number of different definitions had been used:

> 28. The White Paper states that:
>
> > "Personal accounts are particularly targeted at the estimated 7 million people who may not be currently saving enough to give them an income in retirement they are likely to consider adequate. We know that this group tends to be younger and on moderate to low incomes. They are also likely to be part-time workers and/or work for small employers."
>
> 29. The CBI pointed out to us that this was a subtly different definition from that adopted by Lord Turner and his colleagues in the Pensions Commission Report:
>
> > "Lord Turner's principle behind the model that he put forward in his report was that we should be targeting those on low incomes but also those without access to an occupational scheme. Having read the White Paper, we see the DWP's definition of the target market is those not saving, and that is quite a different target from ours. In our response we will be saying that we would like a much clearer and tighter definition of what the target market is […] those on low incomes and those without access to occupational schemes."
>
> 30. Lord Turner, when giving oral evidence to the Treasury Committee during its inquiry into the NPSS proposals in May 2006, described the target group as those earning around £10,000 to 30,000 a year who are increasingly not making any provision on top of the state pension: "That is the core problem that we are trying to fix."
>
> 31. The National Association of Pension Funds recommended that "The Government should adopt a narrower definition of the target group for Personal Accounts" and that the accounts "should be aimed at those employees without access to a good workplace pension with an employer contribution."
>
> 32. The White Paper alludes to these points. It comments, for example, that "Personal accounts will extend the benefits of private pension saving to those on moderate to low incomes who do not have access to a good employer pension scheme." However, there is a certain amount of ambiguity, for example in the Regulatory Impact Assessment which refers to the "needs of the target group, *particularly the majority* on moderate to low incomes." [our emphasis]

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[59] Ibid, para 4.12

[60] Theresa May, *Providing for Pensions*, Politeia, 2010

> 33. In our view, it seems that those who already have access to a good workplace pension should not be encouraged to participate. We also believe that the Government should make its target market intentions clear. [61]

In its response, the Government said:

> 19. Personal Accounts are not being designed to poach people from existing pension providers that are already providing good schemes. The aim of private pension reform is to give more employees access to a workplace pension scheme.
>
> 20. Personal Accounts are just one option available to people and complement the range of options that already exist.
>
> 21. Personal Accounts offer moderate to low earners – a group not currently well served by the pensions industry – access to a low-cost pension savings vehicle with an employer contribution.[62]

DWP now estimates that "3 to 6 million people will be saving in the personal accounts scheme, including some who were previously saving in existing workplace pensions and some who opt-in."[63]

2.4 Information and advice

Section three of *Pensions Act 2008* requires employers to automatically enroll "jobholders"[64] aged between 22 and state pension age into a qualifying workplace pension scheme. A subject of intense debate when the legislation was before Parliament was the extent to which it "pays to save" and whether it was appropriate to encourage pension saving for people who might not gain from doing so.[65] A number of commentators have asked where individuals would go for information and advice to help them decide whether and how much to save.[66]

The Labour Government said the NEST scheme would provide information (though not regulated financial advice) to help individuals make decisions about their participation in the scheme.[67] In addition, it is expected that the trustees will have to raise awareness among employers of the "scheme's existence and the nature of the proposition it offers to employers".[68]

The question of financial advice would be looked at separately, through the Thoreson Review of Generic Financial Advice, and an action plan on financial capability would assess the need to add to those services that are already available.[69]

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[61] Work and Pensions Committee, *Personal Accounts*, Fifth Report of Session 2006-07, HC 220-I, 29 March 2007; DWP, *Personal accounts: a new way to save*, Cm 6975, December 2006
, para 1.1

[62] Report on Personal Accounts. Government response to the Fifth Report of the Work and Pensions Select Committee, Session 2006–07 [HC 220-1], June 2007;

[63] DWP, *Workplace Pension Reform Regulations Impact Assessment,* 12 January 2010, para 5.31

[64] The definition of jobholder is in section one, *Pensions Act 2008.* One of the critieria is that they must have "qualifying earnings" (at least £5,035 in 2006/07).

[65] These issues are covered in more detail in SN 4847 Pensions: Automatic enrolment - background

[66] See, for example, Work and Pensions Committee, *Personal Accounts*, Fifth Report of Session 2006-07, HC 220-I

[67] Report on Personal Accounts. Government response to the Fifth Report of the Work and Pensions Select Committee, Session 2006–07 [HC 220-1], June 2007

[68] DWP, *Pensions – consultation on draft scheme order and rules*, April 2009

[69] PBC Deb, 5 February 2008, c415-6 [James Plaskitt]

2.5 Duty to establish a scheme

The *Pensions Act 2008* requires the Secretary of State to establish the proposed personal accounts pension scheme, treated as if established under a permanent trust (like many other occupational pension schemes) through legislation.[70]

The Labour Government announced on 7 January 2010 that National Employment Savings Trust (NEST) would be the permanent name of the personal accounts scheme.[71]

The National Employment Savings Trust Order 2010 (SI 2010 No. 917) establishes NEST and provides that the NEST Corporation is to be trustee of the scheme.

Timetable

The Labour Government had proposed that the scheme should come into operation at some point in 2012.[72] In debate on the legislation, opposition Members asked for details of the delivery plan, in order to be able to assess whether the target date was achievable.[73] A report on the Personal Accounts Delivery Authority's plan for delivery was placed in the House of Commons Library in May 2008.[74] In debate in the House of Lords, the then Opposition Treasury spokesperson, Baroness Noakes said it provided "little meaningful information and no reassurance whatsoever."[75]

The Labour Government announced in March 2010 that it had reviewed the timetable for implementation of the duties to be imposed on employers (to automatically enrol and make minimum contributions). Auto-enrolment would start as planned in October 2012, but would be introduced over a longer period than had originally been intended, with full roll-out not until 2017:

- Start-up businesses created from 2012 will be given until 2016 to start enrolling staff
- Businesses employing 120,000 staff start enrolling in October 2012, with smaller businesses phased in over the next three years
- Phasing in employer contributions from 1% in 2012 to 2% in October 2016 and to the full 3% by 2017.[76]

The review team set up by the Coalition Government to look again at NEST and auto-enrolment proposed allowing employers to voluntarily auto-enrol from July 2012, ahead of the start of compulsory contributions in October 2012:

> The largest employers, who are scheduled to be brought into the reforms in October and November 2012 should be allowed to automatically enrol ahead of the planned start date of October 2012, and as early as July 2012, if they wish to do so.[77]

[70] Section 67
[71] PADA Press Release 7 January 2010, 'Pada launches new brand for the personal accounts scheme'
[72] See, for example, PBC Deb, 31 January 2008, c301
[73] Ibid, c301-7
[74] DEP 2008-1372
[75] HL Deb, 2 July 2008, c265
[76] DWP Press Release, *12 January 2010 – Millions to get first pension – employers to pay in*
[77] Paul Johnson, David Yeandle and Adrian Boulding, 'Making automatic enrolment work. A review for the Department for Work and Pensions', 27 October 2010, p10

2.6 Costs and financing

The Labour Government estimated the initial cost of establishing the Personal Accounts Delivery Authority as "£21 million between 2006/07- 2008/09."[78] The NEST scheme was expected to be self-financing in the long run, with the costs covered by member charges. However, in the short-run revenue would be insufficient to cover costs. The then Parliamentary Under Secretary of State, Lord McKenzie, explained that the strategy for dealing with this was still being developed:

> While our aim is to create a low-cost pension scheme, we have also made it clear that the personal accounts scheme should be self-financing in the long run. We expect its set-up and operational costs to be recouped from member charges. During the scheme's early years, before revenue flows from charges mature, costs will inevitably exceed revenues. The funding strategy for the scheme will therefore need to find a way of funding this shortfall until revenue from charges is sufficient to cover costs. PADA will advise on the funding strategy, but the exact funding solution will not and cannot be known until the design of the scheme is finalised and the commercial process is under way.
>
> In making its recommendations, the authority will need to consider how to strike the best balance between repaying this shortfall quickly, which could put an unreasonable charges burden on earlier members of the scheme, and taking too long to do so, which could mean passing the cost of additional interest and charges on to all members of the scheme…
>
> Further to this, noble Lords will be aware that the delivery authority has been consulting on the best charging structure for the personal accounts scheme. Previous analysis has shown that there is no easy answer: no structure scores best for members' outcomes, encouraging participation and the sustainability of the scheme. Instead, trade-offs have to be made. It is not wise to pre-empt these careful deliberations by requiring the authority to have regard to an annual management charge. The authority's consultation document explains that there could be other more suitable charging structures for the personal accounts scheme. We should give the authority the opportunity to explore these as part of its wider work on funding the scheme. Therefore, while I agree with the spirit behind this amendment, it is important that we give the authority scope to decide how the set-up and early years' costs of the scheme should best be met.[79]

The insurance industry was concerned about the possibility "of a subsidy being paid to the personal accounts pension scheme to support some of its activities on an ongoing basis."[80] In response, Lord McKenzie said the Government had no intention of unfairly advantaging the scheme but pointed out that it would have to operate under restrictions that did not apply elsewhere in the market:

> It will have a public service obligation because it will have to accept any employer who wants to use it to fulfil their auto-enrolment duty by using the personal accounts scheme and it will have to accept any qualifying employee…The scheme will also be focused on the employers of low to medium earners not provided for by the existing market because they are considered to be uneconomic…Ultimately, this could mean the scheme has to offer a short-term level of charges that undermines our aims to provide low-cost pension provision and to build the scale that it needs to be viable in the longer term. To prevent this, it is reasonable for the Government to consider

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78 *Pensions Bill 2006-07,* Regulatory Impact Assessment, para 3.35-6

79 HL Deb, 10 July 2008, c935

80 HL Deb, 7 October 2008, c220

> whether it could be in the public interest to compensate the scheme and its members for the burdens of the real commercial disadvantages, to which I have referred, to be placed upon it.
>
> But let me be very clear that this is not a statement of intent; no decisions have yet been taken on the best way to fund the establishment of personal accounts…However, I hope the House will be reassured that if the Government felt funding on a non-commercial basis was necessary, they would have to show that this was consistent with European state aid rules.[81]

At Third Reading on 19 November, the Government amended the Bill to make it clear that any financial assistance would be "consistent with the general rules on government lending":

> In particular, the amendments specify that any loans must attract an interest rate consistent with the conditions that would apply under Section 5 of the National Loans Act 1968; that is to say, at a minimum they must cover the Government's cost of borrowing.[82]

The then Opposition Treasury spokesperson, Baroness Noakes, gave this a qualified welcome:

> The Bill still allows non-commercial terms to grants to be made to either the delivery authority or the trustee corporation when that is up and running. I simply note for the record that we on these Benches do not accept the concept of a universal service obligation necessitating long-term subsidy for the personal accounts scheme, but we are grateful for these amendments.[83]

The *Workplace Pension Reform Regulations Impact Assessment* published on 12 January 2010 explained that key issues affecting costs and financing were still to be determined:

- The corporation will be made up of a chair, deputy chair and up to thirteen other members. Together they will form the corporate trustee of the scheme. They will be supported by staff that will carry out the day-to-day running of the corporation's functions.

- The new scheme will be self-financing over the long-term, with the costs of operating the scheme covered by member charges. However, in the short-run before the scheme begins operations and members are fully phased in, there will be costs associated with the set-up of the scheme which cannot initially be covered by members' charges. As a consequence there is a need to finance the cost of setting up and operating the personal accounts scheme in the initial period before revenue from membership charges builds up. The source of this finance is still to be determined.

- Many of the activities required to set up and run the scheme will be outsourced to private contractors. PADA is currently procuring the services required through competitive tendering with private sector providers, and the costs will not be finalised until the Authority has completed this process. At this stage in the development of the personal accounts scheme the Government cannot publish its estimated cost due to commercial confidentiality and the potential risk that doing so could influence the commercial process.

- The Trustee Corporation will also incur some expenditure fulfilling its role as a public body (e.g. costs associated with reporting to Parliament and responding to Freedom of Information (FOI) requests). These are estimated to be less than £1m per annum and the intention is that these

[81] HL Deb, 7 October 2008, c224
[82] HL Deb, 19 November 2008, c1151
[83] Ibid, c1151

costs will be funded via grant-in-aid from Government and will not be included in charges to scheme members.[84]

2.7 Charges

The Pensions Commission found that the retail financial services industry could not profitably serve a segment of the market – employees of average and lower earnings working in small and medium companies, plus many self employed – except at Annual Management Charges (AMCs) "which are disincentives to saving and which substantially reduce pensions available in retirement."[85] One of its aims, therefore, in proposing a National Pension Saving Scheme was to ensure a low cost of operations, providing the "opportunity to save for a pension at the Annual Management Charge (e.g. 0.3% or less) today enjoyed only by employees of large firms, by public sector employees or by high income individuals."[86]

In evidence to the Pensions Bill Committee, the then Pensions Minister, Mike O'Brien said he believed the costs of running the scheme could be got down to 0.3% but that "it may well be 0.5 per cent., at least initially."[87] The then Opposition Pensions Spokesperson, Nigel Waterson, argued that achieving an AMC of 0.3% was a fundamental pillar of the Pensions Commission's proposals and that a case would need to be made "if we propose to leave the door open to a significantly higher annual charge."[88]

PADA published a consultation document on the charging structure for personal accounts on 29 January 2008.[89] This explained that there were a number of different ways in which members of NEST could be charged:

> 12. Annual management charge (AMC). Members pay a fixed proportion of their funds under management each year until they retire, including those years when no contributions are made.
>
> 13. Contribution charge. Charges are levied as a percentage of each contribution paid into an individual's pension pot: by the individual, their employer and the Government (in the form of tax relief).
>
> 14. Joining fee. Members pay a one-off, upfront fee on joining the scheme. This can be levied as a flat fee or as a proportion of each member's contributions over a given period (for example, equivalent to two months of their first year's contributions). A joining fee on its own would be insufficient to cover the costs of personal accounts: it would have to be levied in combination with other charging structures.
>
> 15. Contribution charge with an AMC. This is a combination of two of the charging structures mentioned above.[90]

A summary of responses to the consultation published in July 2008 found "no clear consensus view on the most appropriate charging structure for personal accounts":

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[84] Annex to Explanatory Memorandum to National Employment Savings Trust Order 2010 (2010 No. 917)
[85] Pensions Commission, Second Report, November 2005, p 3
[86] Ibid, p 7
[87] PBC Deb, 17 January 2008, c113
[88] PBC Deb, 5 February 2008, c369
[89] PADA, *Building personal accounts: choosing a charging structure*, January 2008. PADA published a research report, *'Personal accounts: Attitudes and reactions to possible charging structures'*, on 4 March 2008. See NEST consultation archive – choosing a charging structure
[90] PADA, *'Building personal accounts: choosing a charging structure. A discussion paper to support consultation'*, January 2008, p 3

For the most part, responses were broadly split in favour of one of the following two options proposed in the discussion paper:

• an AMC-only structure; and

• a contribution charge with an AMC.

14. In general, respondents who supported one of these options tended to oppose the other: those who supported an AMC-only structure disliked a contribution charge with an AMC, and vice versa. A minority of respondents said they would be supportive of either approach.

15. There was only very limited support for either a contribution charge on its own or a joining fee with an AMC, but significant opposition to both of these options.

16. Most respondents supported additional charges for particular activities as a way of ensuring that the headline charge was kept low. Respondents suggested drawing up a core set of services, and levying an additional charge for any other services offered. This would keep the scheme simple while allowing for additional charges.

17. Whether in favour of additional charging or not, all respondents highlighted the importance of keeping the product proposition for personal accounts simple. This was considered important as a way to reduce the number of services potentially requiring additional charges, and to reduce administration costs.

18 In designing the personal accounts scheme, the delivery authority will aim to keep the product proposition for personal accounts simple, as a way of keeping scheme costs down. Building simplicity into the scheme will include designing a set of core services that will be covered by the headline charging structure, and seeking to limit those areas where additional charges may be required.[91]

In March 2010, the Labour Government announced that NEST would have a combination charge made up of an annual management charge (AMC) and a charge on contributions:

NEST will be paid for by member charges. In the long term, it will be self-financing, and Government expect it to realise the Pensions Commission's ambition of a charge level as low as 0.3 per cent of members' funds under management-an annual management charge (AMC) of 0.3 per cent.

Nevertheless, NEST will need to meet set-up and operational costs incurred in the period before charge revenues are sufficient to meet the full costs of the scheme. Therefore, NEST is expected to make a small additional charge on contributions of around 2 per cent., until set-up costs are extinguished.

This means the members of NEST, many of whom are expected to have low and moderate earnings, will, for the first time, be able to save for a pension while facing charges at levels currently only available to higher earners, or those accepted into large pension schemes.

NEST will have a public service duty, to accept all employers who want to use the scheme to discharge their duty to automatically enrol workers, irrespective of costs. This means NEST will be required to bear costs other pension providers do not face. In recognition of this, and in order to preserve the scheme's low-cost aims, the Government intend to provide relief to the scheme to limit the overall interest charges

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[91] PADA, *Building personal accounts: choosing a charging structure. A summary of responses following public consultation*, July 2008

scheme members incur on funds borrowed to the Government's cost of borrowing. The Government are currently seeking the European Commission's approval that this approach is consistent with European rules on competition and state aid.

The Government believe that this funding package represents a fair balance between delivering good value to NEST's members, ensuring affordability for the taxpayer and putting NEST on a level playing field with the existing pensions industry.[92]

The *Financial Times* reported some concerns that the initial two per cent charge on contributions might discourage some from saving. Others considered it a reasonable compromise. The then Conservative Opposition was reported to be still concerned about the size of the set-up loan and how long it would take to pay back.[93]

2.8 Investment strategy

Decisions on investment are to be the responsibility of the NEST trustees (as is the case with other defined contribution occupational pension schemes).[94] In debate in Parliament, both Conservative and Liberal Democrat Opposition parties argued that there should be a requirement to have regard to the United Nations principles for responsible investment.[95] The then Pensions Minister, Mike O'Brien argued that this should be a matter for the trustees:

> The law already requires the trustees of all occupational pension schemes to state the extent to which social, environmental and ethical considerations have been taken into account in their statement of investment principles…It is possible today for the trustees of various schemes to choose to adhere to the UN principles in the statement of investment principles that they set out. We would applaud them for doing so, but the Liberal Democrats and the Conservatives appear to be advocating that a significant further step should be taken. Effectively, it would rewrite much of trust law.[96]

Furthermore, the issue would be considered in the course of public consultation on the investment strategy.

PADA published a discussion paper, *Building personal accounts: designing an investment approach* in May 2009. A document setting out key findings from the consultation said:

- It would be important to build the investment approach around the needs, wants and aspirations of NEST members;
- Although it would be important to get the investment objective right, there was no consensus on what it should be. Under consideration was a 'benchmark' objective, aimed at achieving a certain return in excess of inflation, after management charges;
- Respondents to the consultation thought a range of asset classes should be used and that the dominant investment style should be passive, in order to meet the commitment to deliver personal accounts at low cost;
- There was a strong consensus that "responsible ownership" should feature in the investment approach of personal accounts (although there was less agreement on how this should be delivered). PADA defined responsible ownership as "the responsible use of ownership rights attached to assets to protect and enhance shareholder value over the long term. This is achieved primarily through voting and

[92] HC Deb, 16 March 2010, c57-8WS
[93] Nicholas Timmins, Initial charge for new pension set at 2%, *Financial Times,* 17 March 2010
[94] Explanatory Notes to the *Pensions Act 2007*, para 429; DWP, *Pensions Bill – Impact Assessment*
[95] HC Deb, 22 April 2008, c1258 62; [Nigel Waterson and Danny Alexander]
[96] Ibid, c1266

engagement to influence companies to consider corporate governance, social and environmental risks and opportunities."[97]

In some areas, more research and analysis was felt to be required. PADA's advice to the trustee corporation on the investment approach is to be finalised in Summer 2010.[98]

Choice of funds

The Pensions Commission recommended that its proposed National Pensions Savings Scheme (NPSS) should offer a limited number of funds. It concluded that there were strong arguments against offering a wide range of funds, including: the impact on charges; the fact that too many options made it more difficult for people to make a choice; and the fact that people who wanted a wide range of choices could opt out of the NPSS.[99] The Commission considered that there were two reasons for having a default fund within the NPSS. One was that some people would not return asset allocation forms. The other was that:

> Many people do not feel well-equipped to make asset allocation decisions and welcome the 'implicit advice' inherent in the designation of a default fund. Most DC occupational funds which allow member fund selection therefore specify a default…These are typically either low risk/return funds (e.g. in bonds) or 'lifestyle' smoothing funds, which move people from equity rich portfolios to bond rich portfolios as they approach retirement.[100]

The Commission recommended that the NPSS should "negotiate fund management mandates covering major asset classes (e.g. 6-10 in number) aiming for very low fees in return for the expectation of large fund volumes." These could be combined with the ability to offer funds at non-negotiated fees, possibly including the option of investing in "what are sometimes labelled 'alternative asset classes' (e.g. private equity funds or hedge funds) or in funds designed to be ethical, environmentally responsible, or appropriate to particular religious groups."[101]

The Government's Personal Accounts White Paper, published in December 2006 proposed a three-tiered approach to fund choice:

- A default fund for members who do not wish to exercise a choice;
- A small number of bulk-bought funds at low charges; and
- A wider number of funds, which we expect to include social, environmental and ethical investment and branded funds.[102]

In response to PADA's consultation on designing an investment approach, the majority of stakeholders supported offering some degree of choice outside the default fund. They recommended keeping fund choices clear, simple and small in number to help members make sensible decisions and be consistent with a low-charge scheme. There was general agreement that the number of switches between funds by members should be constrained. Respondents were divided on whether alternative funds should be "lifestyled" and whether

[97] For more information – see National Archives – NEST consultations - investment
[98] PADA, *Key findings from the investment consultation*, 25 November 2009, Executive summary
[99] Pensions Commission, *A New Pension Settlement for the Twenty-First Century. The Second Report of the Pensions Commission*, November 2005; p373-6
[100] Ibid, p 378
[101] Ibid, p376
[102] DWP, *Personal accounts: a new way to save*, December 2006, Cm 6975, p11

costs should be "ring-fenced" so that there was no cross-subsidy between the default and alternative choices.[103]

The default fund

The Pensions Commission recommended that:

> the default fund in the NPSS should be a "lifestyle" smoothing fund which automatically shifts members from high equity allocations at earlier ages to index bond allocations as they approach retirement. Within the spectrum of specific 'lifestyle' fund designs it should probably be towards the cautious end. But it should be made clear that the government provides no guarantee of a minimum return on this fund, and it could under certain (however rare) circumstances perform worse than real government bonds..[104]

The Personal Accounts White Paper specified the characteristics that the default fund should have in order to "ensure that individuals who do not make an active investment choice are defaulted into an appropriate investment":

- The default fund will be structured to deliver an appropriate trade-off between risk and return for the target group;
- The default fund will be invested across many different assets classes to reduce specific investment risk; and
- The default fund will be lifestyled so that, for example, an individual's investments will be moved out of equities into bonds as they appropriate retirement age to ensure the timing risk related to accessing an annuity is reduced.[105]

The Personal Accounts Delivery Authority issued a consultation document on the charging structure for personal accounts on 29 January 2008. This raised the important question of:

> how far, if at all, members should face additional charges for choosing funds with higher fund management costs—or whether other members should subsidise these costs.[106]

A summary of responses to the consultation was published on 15 July 2008.[107]

Most respondents to PADA's 2009 consultation on designing an investment approach appreciated the need for 'lifestyling' in the default fund and thought "target date funds" (where members are placed into a fund that corresponds to their expected retirement date) would be easier to communicate to members, administratively simpler, have greater cost efficiency and offer increased flexibility. [108] Some stakeholders felt that a strategy with lower levels of investment risk in the early years might help encourage people to save. [109]

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[103] PADA, *Key findings from the investment consultation*, 25 November 2009, Executive summary

[104] Pensions Commission, *A new pensions settlement for the twenty first century. The second report of the Pensions Commission*, November 2005, p373-6

[105] DWP, *Personal accounts: a new way to save*, December 2006, Cm 6975, para 5.11

[106] PADA, *Building personal accounts: choosing a charging structure,* January 2008, para 2.19; See National Archives – NEST – Choosing a charging structure

[107] DWP, *Personal accounts – summary of responses to consultation*, June 2007, page 31

[108] *Building personal accounts: designing an investment approach*

[109] PADA, *Key findings from the investment consultation*, 25 November 2009, Executive summary

2.9 Cap on contributions

The *Pensions Act 2008* requires the Secretary of State to set out in the Order the maximum amount a member of the personal accounts scheme can contribute (including the employer contribution and tax relief) in a tax year.[110] It can also set out what contributions count towards the limit and how any excess contributions can be refunded. There has been some discussion regarding the level at which the annual cap on contributions should be set and whether there should be flexibility to allow additional, one off, lump sum contributions.

As regards the annual cap on contributions, the Pensions Commission initially proposed that this should be £3,000:

> This approach would mean that lower earners would effectively be free of any cap (since they would be unlikely to be able to use the freedom) while limiting the extent to which higher earners could use the NPSS as a low-cost alternative for pension saving that is already in many cases occurring.[111]

The December 2006 Personal Accounts White Paper said that the Department's analysis suggested that a contribution limit of £3,000 would "overly restrict the potential for voluntary saving". It asked for views on whether the limit should be least £5,000. It also proposed that the personal accounts board should be able to review the limit. A higher limit (£10,000) was proposed for the first year. This was to help those who wanted to move accumulated funds from non-pensions saving into personal accounts.[112]

The Work and Pensions Committee recommended that there should be some flexibility:

> … if there is to be a cap it should incorporate a certain amount of flexibility, allowing people to make greater contributions at certain times, either because they have a lump sum to invest or because they want to make up for years when they did not contribute. Secondly, we would urge the Government to consider whether a separate cap, set substantially higher than £5,000, should be allowed for firms that are willing to pay significantly more than the statutory minimum employer contributions.[113]

In its response, the Labour Government said it had decided that the appropriate level for the annual cap on contributions would be £3,600, based on 2005 prices to compare directly with the Pensions Commission's proposal, and updated with earnings from that point to implementation in 2012 and beyond.[114] It had asked the Personal Accounts Delivery Authority (PADA) to explore the possibility of an additional lump sum contribution limit, to run alongside the annual limit.[115]

In the event, it accepted PADA's recommendation that there should not be a higher contribution limit for the first year or a separate lifetime lump sum limit. The then Parliamentary Under Secretary of State, Lord McKenzie, explained:

> The delivery authority has provided its advice and recommended against having a higher limit of £10,000 in the first year of the scheme or introducing a lifetime lump sum limit when the scheme commences because that would introduce additional

[110] Section 70; Pensions Act 2008 - Explanatory Notes – para 165-168

[111] Pensions Commission, *A new pensions settlement for the twenty first century. The second report of the Pensions Commission*, November 2005

[112] DWP, *Personal accounts: a new way to save*, December 2006, Cm 6975

[113] Ibid

[114] Report on Personal Accounts, *Government response to the Fifth Report of the Work and Pensions Select Committee*, Session 2006–07 [HC 220-1], June 2007, Cm 7122; para 88-92

[115] Ibid, para 90

complexities and complicate communication with individuals as well as increase risk for the administration of the scheme. It has also recommended that we reconsider the lifetime lump sum facility in 2017 when the scheme is fully up and running and when we know more about the saving behaviour of the target market. We have considered its advice very carefully and accepted its recommendation.[116]

The limit on contributions is in the Scheme Order.[117]

The October 2010 review of NEST recommended that the annual cap should be removed once the staging in of employers was complete:

> Two particular policy variables also need to be considered in the context of NEST. The first is the current limit on contributions, set at £3,600 a year in 2005/6 terms (equivalent to £4,300 today). This limit has been imposed in the interests of ensuring that NEST remains focussed on its target market, those employers and individuals the pensions market currently finds too difficult to serve, and does not compete unfairly with the existing pension industry. We have two concerns about this limit. First, it has created a great deal of complexity and cost for the set up of NEST. Second, and in the long term more importantly, we are concerned that it will send the wrong message about what constitutes a reasonable ceiling on the pension saving that people need to do.
>
> Given that we do understand industry concerns about possible competition as automatic enrolment is introduced and in that period it is important that NEST does continue to focus on its core constituency, we do not recommend any change to the cap in the short run. But we do recommend that it be removed once the staging in of employers is complete, and that Government legislate for this at an early stage.[118]

The other issue the review team thought should be considered further was the prohibition on transfers (see below).

2.10 Prohibition on transfers

The Labour Government had proposed a general prohibition on "transfers between personal accounts and other pension products and schemes", to protect the existing pensions market:

> 7.16 A prohibition on transfers between personal accounts and other schemes could help to minimise any market disturbance during the transitional period. It would remove the possibility of existing schemes moving funds into personal accounts. This measure would help to ensure that personal accounts remain focused on the target market of moderate to low earners who do not have access to good pension provision.[119]

However, there are some exceptions. For example, individuals who leave a qualifying scheme before their rights vest will be able to transfer their cash transfer sum into the NEST scheme.[120]

The October 2010 review of NEST recommended that the prohibition on transfers should be reviewed as a matter of urgency:

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[116] HL Deb, 7 October 2008. c187; See also PBC Deb, 31 January 2008, c326 [Mike O'Brien]

[117] *Pensions Act 2008*, Section 70; *National Employment Savings Trust Order 2010* (SI 2010/917), Part V; DWP, *Workplace Pension Reform Regulations Impact Assessment*, 12 January 2010, par 5.36-8

[118] Paul Johnson, David Yeandle and Adrian Boulding, 'Making automatic enrolment work. A review for the Department for Work and Pensions', 27 October 2010, p7

[119] DWP, *Personal accounts: a new way to save*, December 2006, Cm 6975

[120] DWP, *Workplace Pension Reform Regulations Impact Assessment*, 12 January 2010, para 5.39-40

> Many people move between employers many times in their working lives, about 11 times on average. If they move between employers with different pensions schemes, they could easily end up with 11 or more different pension pots on retirement. This is difficult for individuals to deal with and expensive and inefficient for pension providers.
>
> But regulation makes moving pensions between one scheme and another very difficult, and few people do so. We believe that for the reforms to be truly effective it will need to be straightforward, indeed the norm, for people to move their pension pot with them as they move employer. We believe that Government and regulators need to review this issue as a matter of some urgency. It is in this context that we believe that NEST should be able to receive transfers in and pay transfers out, but only once automatic enrolment is established and the more general issue of pension transfers has been addressed.[121]

2.11 2017 review

Section 74 of the *Pensions Act 2008* requires a review in 2017 of two aspects of the NEST scheme that are designed to "focus it on the target market" (i.e. the policy on contribution limits and restricting pension fund transfers to and from the scheme.") The Secretary of State may also bring other topics within the scope of the review.[122]

The October 2010 review team said it was important for the Government to have in place a comprehensive programme of monitoring and evaluation:

> Finally, it is important to remember what a big policy innovation automatic enrolment is. There is, inevitably, a great deal of uncertainty about its actual impact and how individuals and employers will respond. We take this uncertainty as read throughout this report. Given the novelty and importance of the policy, and the associated uncertainty, we think it particularly important that Government have in place a comprehensive programme of monitoring and evaluation.[123]

2.12 Method of collecting contributions

The summary of responses to the Personal Accounts White Paper said that most respondents wanted the Government to explore using HMRC's Pay As You Earn system to facilitate the collection of Personal Accounts contributions. The Work and Pensions Committee was concerned that so little detail was available:

> 230. We are concerned that there is so little detail available on the architecture and costs of payment collection, a fundamental piece of the personal accounts scheme infrastructure. While it is right that the Delivery Authority should be responsible for making the contractual arrangements, it must do this after the different options have been fully explored and their feasibility tested and discussed. We would have expected the thinking on such a crucial keystone in the operation of the scheme, for employers, employees and the Authority and Board, to be more advanced at this stage, and we are deeply concerned that it is not. This ambiguity could mean that the Government's choice of model is based on flawed assumptions and logic.
>
> 231. In our view, giving the PAYE scheme additional functionality to collect contributions should not be ruled out, given the strength of feeling amongst employers,

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[121] Paul Johnson, David Yeandle and Adrian Boulding, 'Making automatic enrolment work. A review for the Department for Work and Pensions', 27 October 2010, p8

[122] *Pensions Act 2008 – Explanatory Notes, para 176-8*; See also HL Deb, 19 November 2008, c1148

[123] ul Johnson, David Yeandle and Adrian Boulding, '*Making automatic enrolment work. A review for the Department for Work and Pensions'*, 27 October 2010, p8

> the TUC and other organisations on this point. DWP and HMRC, acting jointly, should conduct an urgent review on the options for payment collection, as part of the HMRC's major ongoing programme to modernise the PAYE process. [124]

In its response the Government explained why it did not think the PAYE system would be appropriate:

> 95. The Government acknowledges the Committee's view. It has explored the options of collection with stakeholders and will continue to do so. As the Select Committee noted, Her Majesty's Revenue and Customs intends to modernise its Pay As You Earn systems – however, these changes, alone, will not enable Her Majesty's Revenue and Customs to meet the requirements of Personal Accounts.
>
> 96. The inherent time lag in the existing Pay As You Earn system means that it is unlikely to be suitable for Personal Accounts. The Pay As You Earn system requires employers to pay over money they have deducted every month, but does not require any information about that money to be reported until after the end of the financial year to which it relates.
>
> 97. Using this system, contributions to Personal Accounts could not be allocated to the individual's choice of fund until the information identifying their individual contributions was provided to the Personal Accounts scheme up to 18 months after it had been deducted. It would also be impossible, without adding significant information requirements, to identify when in the year any particular contribution had been made, and the precise return on each individual's funds in the period prior to investment.
>
> 98. This delay would also mean that there was no validation of who the payment related to when it was made. For Personal Accounts, there would need to be extra processes for handling contributions where the payment cannot not be matched to an individual. The planned modernisation of the Pay As You Earn system will not, on its own, result in it meeting the needs of Personal Accounts.
>
> 99. One of the core principles driving work on the delivery of Personal Accounts is that burdens on employers are minimised. The Government will therefore continue to review all the options and will work with the Personal Accounts Delivery Authority to design a collection process that minimises costs to employers. The objective will be to align with employer processes as far as possible and be compatible with existing payroll processes and systems, best practice and IT functionality.
>
> 100. In conclusion, the Government's current view is that Pay As You Earn is unlikely to meet the core requirements for Personal Accounts. However, the final decision on this issue will be made on the basis of an appraisal of the risks, costs and benefits of the options available, as part of wider impact assessment work.[125]

PADA commissioned an independent review of collection options for the personal accounts scheme.[126]

2.13 Accessing savings

Personal Accounts are to be subject to the same tax rules as other tax-favoured pension schemes:

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[124] Work and Pensions Committee, *Personal Accounts*, 21 March 2007, HC 200-I, 2006-07

[125] Report on Personal Accounts. Government response to the Fifth Report of the Work and Pensions Select Committee, Session 2006–07 [HC 220-1], Session 2006–07 [HC 220-1], June 2007, Cm 7122

[126] DWP, *Pensions Bill – Impact Assessment*, 5 December 2007, para 3.50

Tax relief will be provided on contributions to Personal Accounts under the simplified tax regime introduced in April 2006 to encourage individuals to save for an income in retirement. In return, the same rules will apply to how the accumulated pension fund will be converted into a regular of income in retirement:

- income from Personal Accounts cannot be accessed until the scheme member reaches 55 years of age and income must be secured by the time that person reaches 75 years of age;
- a quarter of an individual's total pension fund will be available as a tax-free lump sum;
- an individual with a total pension accumulation of less than 1 per cent of the lifetime limit (£16,000 in 2007/08) will not be required to secure their income by purchasing an annuity and can take their pension as a taxable lump sum; and
- if an individual dies before age 75 without accessing their pension savings a pension or lump sum will be payable to dependants.[127]

The detailed processes by which people accessed their savings was subject to a detailed consultation. In a discussion paper published in December 2008, PADA sought views on the following key propositions:

- lifetime annuities will be the best product for most people in our target market, particularly in the early years of the scheme;
- whilst a significant number of members will be able to secure an annuity through the open market option, many members will need an alternative to this;
- to strike a balance between a scheme that meets the needs of members whilst remaining low-cost, we need to develop a principally self-service customer experience, maximising the increasing potential of internet and other electronic media, complemented by other channels;
- to support members not wanting to use the open market option the scheme will source annuities through a panel of providers; and
- since we want to be fair to all members, we need to address issues raised by people with small pension funds, or funds that the member cannot access.[128]

In a summary of responses following the public consultation, published in May 2009, PADA said that most respondents had agreed that lifetime annuities were the best option for NEST members.[129] Responses to the proposals on how members should be guided in their choices about annuities were mixed:

> This would largely be a self-service method, automated as much as possible to keep costs to members low. While generic information on the types of annuities would be available to members, we would not provide the member with any regulated financial advice. There were mixed views in response to this question, with some respondents feeling there was no alternative and others considering even this approach to be too complex for personal accounts members.

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[127] DWP, *Personal accounts: a new way to save. Summary of responses to the consultation*, Cmnd 7121, June 2007, p57;

[128] PADA, *Building personal accounts: securing a retirement income. A discussion paper to support consultation*. December 2008

[129] PADA, *Building personal accounts: securing a retirement income. A summary of responses following public consultation*, May 2009

[…]

A number of respondents recommended a default option in order to simplify the process even further whereas others recommended extending the range to include impaired life and enhanced options.

PADA proposed that there would be a panel of providers for individuals who did not want to use the open market option to select an annuity provider. Opinion was divided on how often membership of this panel should be reviewed. PADA is to engage further with the potential supplier market on how to deliver an optimal solution.

Opinion was also divided on what solution there might be for people with small pension funds who currently struggle to find a willing provider:

> Some respondents felt that the annuities market would start to cater for smaller funds if costs could be reduced and processes made simpler since they would become more viable for providers and advisers to deal with. Other responses felt that a change in legislation would be required […]

Early access to pension saving

A number of commentators have suggested people should be allowed early access to some of their pension saving.[130]

The Pensions Policy Institute (PPI) has looked at whether allowing early access to pension might increase retirement incomes. There were a number of possible models for doing this, depending on the overall objective:

> If the policy objective is to minimize the potential reduction in the value of individual pension funds, then allowing loans, feeder funds or early access to lump sums, seems to have less potential for reduction in individual pension fund size than allowing permanent withdrawal does.
>
> Overall, whilst allowing loans has slightly more potential for increasing individual pension pot sizes than allowing feeder funds or early access to lump sums, if people do not repay their loans then allowing loans could put individual's pension funds at risk.
>
> Allowing early access to pension saving could increase or decrease the aggregate size of pension funds under management in the UK. The overall effect will depend on the extent to which allowing early access encourages individuals to save more and the extent to which individuals actually exercise their right to withdraw funds early. A 'loans and withdrawals' model seems to offer greater scope for a positive overall impact on levels of pension saving than a model which permits permanent withdrawals only.[131]

There were a number of policy options for mitigating the reduction in savings levels that early access could cause:

- A minimum, mandatory contribution level of 1% above the standard rate could be required from people who wish to use early access options (i.e. 5% minimum employee contribution rather than the 4% that will be required for those auto-enrolled into pension saving after 2012). There could be a condition that people

[130] See, for example, HL Deb, 23 June 2008, c1283 [Baroness Hollis]

[131] PPI, *Would allowing early access to pension savings increase retirement incomes?* November 2008; Executive Summary

pay the increased contribution for a period of at least five years before they access their pension fund.

- Conditions for withdrawals, or a minimum length of contributions to qualify for access.
- The setting up of an advice system able to inform people of the risks posed by early access.
- A system for ensuring the majority of loans are repaid, if the 'loans and withdrawals' model is adopted.
- A penalty tax on withdrawals or limiting withdrawal conditions to severe financial hardship.[132]

In a report published in early April 2009, Steve Webb (then the Liberal Democrat Work and Pensions spokesperson, now Pensions Minister) argued that people should be allowed early access to the 25% tax free lump sum:

- Most people are already able to draw up to a quarter of their accumulated pension when they retire, in the form of a tax free lump sum. The exact rules vary between types of scheme, but the vast majority of people saving through a pension are entitled to this lump sum.
- If this lump sum were made available to people before retirement, it could make a huge contribution to their individual finances. The value of the lump sums that have already been accrued could, if drawn down and used for current spending, produce a huge stimulus for the domestic economy[133]

The Conservative Liberal Democrat Government said in May 2010, that it would "explore the potential to give people greater flexibility in accessing part of their personal pension fund early."[134]

2.14 Tax relief on contributions

As recommended by the Pensions Commission, the Government has set minimum contribution levels at 8 per cent. This is to comprise of 3 per cent from the employer, 4 per cent from the employee and the State contributing 1 per cent as normal tax relief, as under the current rules.[135] The then Opposition Spokesperson, Baroness Noakes, asked what the mechanism would be to deliver tax relief to members of personal accounts. Lord McKenzie explained that:

> The Government have decided that personal accounts will use the relief at source method for delivering tax relief to members…Under this method of paying tax relief, the individual saves up to £2,880 in any one tax year and the Government add another £720, giving a total pension savings with tax relief, irrespective of whether the individual is otherwise subject to tax, of £3,600.[136]

[132] Ibid
[133] Steve Webb and Jo Holland, *Setting Pensions Free*, April 2009
[134] The Coalition: Our programme for Government. Pensions and Older People
[135] DWP, *Security in retirement: towards a new pensions system*, CM 6841, May 2006, para 1.106
[136] HL Deb, 7 October 2008, c137

The *Finance (No 2) Bill 2010-11* includes provision to enable NEST to register as a pension scheme for tax purposes.[137] HM Treasury explained that this would "mean that members of NEST and contributing employers would be able to benefit from the tax reliefs available to registered pension schemes on contributions and investment growth and to be subject to the same tax rules as other tax-registered pension schemes."[138]

3 Operation and governance

3.1 Personal Accounts Delivery Authority (PADA)

The Personal Accounts White Paper explains that the work "to ensure that financial, commercial and operational implications are fully understood, and the most effective systems and structures are put in place to deliver personal accounts" will fall broadly into three stages:

> Stage 1 – finalising the detailed policy design and developing a commercial and procurement strategy within the framework set by legislation.
>
> Stage 2 – implementing the commercial and procurement strategy: design, build and test of systems.
>
> Stage 3 – managing a fully operational personal accounts scheme.[139]

To enable preparatory work to be done, Sections 20 to 23 of the *Pensions Act 2007* legislated for stage one, establishing a Personal Accounts Delivery Authority (PADA), referred to in the Act as "the Authority". The Explanatory Notes to that Act say:

> 94. The Authority is being established with a remit limited to:
>
> - Providing advice and recommendations to Government, helping it to think through the operational and commercial implications of its policy options.
>
> - Preparing for the implementation of a personal accounts scheme, such as formulating a commercial strategy for the personal accounts scheme by preparing specific products which comprise a financial, technical and commercial strategy.
>
> 95. The Authority will be at a distance from Government and will be able to manage its own affairs. Schedule 6 gives details on the membership and structure of the Authority.[140]

In its second stage, PADA was to have a broad remit "assuming responsibility for delivering the Personal Accounts scheme and wider reforms, within a framework set by Government." The objectives for this executive stage would be to:

- design and build an infrastructure that will enable employers to provide automatic enrolment and employer contributions for eligible employees to a qualifying pension scheme; and
- to establish the infrastructure for Personal Accounts within a framework set by legislation and with regard to the interests of future scheme members.[141]

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[137] HM Treasury, Budget 2010, HC 61, June 2010
[138] HM Treasury, BN23. Pensions Taxation: NEST
[139] DWP, *Personal accounts: a new way to save*, Cmnd 6975, December 2006, page 80, para 3.3-3.4
[140] *Pensions Act 2007*, Explanatory Notes, paras 94-5
[141] DWP, *Personal accounts: a new way to save. Summary of responses to the consultation*, Cmnd 7121; June 2007; p31, para 17

The *Pensions Act 2008* provided for a broadening of PADA's functions:

> 207. Specifically, this section provides for the Authority to give any assistance or advice on the establishment and operation of the scheme that the Secretary of State may require, and any advice that the Authority considers it appropriate to provide. Similarly, it also provides for the Authority to provide such assistance or advice on arrangements to enable employers to comply with their new duties (in Chapter 1) that the Secretary of State or the Pensions Regulator may require, and any advice that the Authority considers it appropriate to provide.
>
> 208. The section provides the Authority with an ancillary power which will allow it to do anything necessary to enable it to carry out its functions or in connection with those functions. For example, this will allow the Authority to enter into formal negotiations and to finalise contracts, and to borrow money to allow it to carry out its functions.[142]

The first chair of PADA - Paul Myners – left to take up a post in Government as Financial Services Secretary in October 2008. Jeannie Drake – a former member of the Pensions Commission – was appointed acting director. Tim Jones was appointed Chief Executive.[143]

Principles

As promised in the Personal Accounts White Paper, the *Pensions Act 2008* requires PADA to consider a number of guiding principles when carrying out its functions:

> (2) The principles are that—
>
> (a) participation in qualifying schemes should be encouraged and facilitated;
>
> (b) the burdens imposed on employers as a result of this Part should be minimised;
>
> (c) any adverse effects on qualifying schemes, and members and future members of those schemes, as a result of implementation of Chapter 5 of this Part should be minimised;
>
> (d) the cost of membership of a scheme established under section 67 should be minimised;
>
> (e) the preferences of members and future members should, so far as practicable, be taken into account in making any provision about investment choice in such a scheme;
>
> (f) diversity among members and future members of such a scheme should be respected.[144]

An effect of these principles is that PADA will "have to consider in carrying out its functions how to encourage those people with moderate to low incomes, who are not currently saving for a pension, to make provision for their retirement."

In debate in Public Bill Committee, the then Parliamentary Under Secretary of State, James Plaskitt explained that at times it would be necessary to resolve competing priorities:

> The intention is not that each of these principles should be achieved in its own right, rather that they must together underpin the authority's day-to-day work and be

[142] *Pensions Act 2008 – Explanatory Notes*
[143] PADA, '*Annual report and accounts', 26 July 2007 to 31 March 2008*, HC 949
[144] Section 80

> considered as a whole. Indeed, the very nature of the principles means that they will, at times, require a resolution of possible competing priorities.[145]

There would be a number of opportunities for monitoring how PADA was taking the principles into account, including, for example, its annual report.[146]

The Personal Accounts Delivery Authority – Framework Document was placed in the Library of both Houses of Parliament on 27 February 2008.[147] A further Framework Document document has now been published, effective from 1 October 2009.[148]

Strategic goals

PADA's goals are designed to support delivery of the Government's Public Service Agreement 17 (to "tackle poverty and promote greater independence and well-being in later life") and Departmental Strategic Objective 4 (to "promote independence and well-being in later life, continuing to tackle pensioner poverty and implementing pension reform"). Its strategic goals are:

- Establishing an occupational pension scheme by 2012 which delivers the best possible pension scheme for its members at low cost, and is:
    - straightforward
    - attractive to employers and open to all employers; and
    - economically sustainable to future generations;
- Setting up a trustee corporation with an excellent governance framework, which attracts high calibre trustees, and managing a smooth and successful handover to the trustees;
- Delivering valued advice and support to its strategic delivery partners; and
- Building the Authority as an organisation that engenders confidence and is an asset in launching the new scheme.

> 3.2.3. Details of the activities, performance measures and targets that contribute to delivery of the Authority's strategic goals are agreed with the Department each year as part of the Authority's corporate and business planning process.[149]

Directions and guidance

Section 81 of the *Pensions Act 2008* allows the Secretary of State to give directions and guidance to PADA on anything to do with the discharge of its functions. In turn, PADA is required to consider any guidance and comply with any direction.[150]

Winding up the authority

It was always intended that PADA would be in existence for a limited period, with a remit een to advise and assist the Secretary of State in designing and setting up the new scheme.[151] A

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145 PBC Deb, 5 February 2008, c392; See also HL Deb, 10 July 2008, c923-5
146 PBC Deb, 5 February 2008, c392-3
147 Dep 2008-0572
148 Dep 2009-3014
149 Personal Accounts Delivery Authority, Framework Document. Effective from 1st October 2009, Dep 2009-3014
150 *Pensions Act 2008 – Explanatory Notes*, para 212 ; See also HL Deb, 10 July 2008, c940-1
151 *Pensions Act 2007*, section 23, as amended by *Pensions Act 2008*, section 79

successor body - the National Employment Savings Trust (NEST) Corporation – would be responsible for the scheme once it was up and running.[152]

PADA is to be wound up from 5 July 2010 and its property, rights and liabilities transferred to the NEST Corporation or the Secretary of State.[153] This is because:

> 7.2 By July 2010 the Authority will have completed its work; the scheme design (including the scheme order and rules) will be finalized, and the procurement processes for services to support the operation of the scheme will be well advanced. Any remaining implementation will be complemented by the NEST Corporation who will have ongoing responsibility for the operation of the scheme. Some implementation activities – including for example those dependent on the adoption of a Statement of Investment Principles – can only be completed by the trustee.[154]

3.2 National Employment Savings Trust (NEST) Corporation

The *Pensions Act 2008* provided for the establishment of *a* trustee corporation to: set the strategic direction of the scheme; monitor performance; run the scheme within the terms of the scheme order and rules as well as general tax and trusts law; set and review the investment strategy; and make and amend scheme rules within the parameters of the scheme order.[155]

The *National Employment Savings Trust Order 2010* (SI 2010 No 917) provides for the NEST Corporation to be Trustee of the Scheme. The Corporation is to be a non-departmental body.[156] It will not be a Crown servant or agent and will therefore not “benefit from such status, immunity or privilege, not can its property be considered as belonging to the Crown.”[157] In debate, the then Pensions Minister, Mike O'Brien, explained that the trustee corporation would “run the scheme in the sole interest of its members and independently of the Government, so its loyalty will be not to the Crown, but to the members.”[158]

In March 2010, Lawrence Churchill – former chair of the Pension Protection Fund – was appointed Chair Designate of the NEST Corporation. Jeannie Drake is Deputy Chair Designate.[159]

Details of the appointment of trustees and issues such as conflicts of interest, disqualification and removal and remuneration are in schedule one of the *Pensions Act 2008*.[160]

Scheme rules and orders

The *National Employment Savings Trust Order 2010* (SI 2010 No 917) published on 25 March 2010 establishes NEST. The Order is the “broad equivalent of a trust deed, a legal document which establishes a trust, under which money or other assets are held on behalf of someone else.”[161]

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[152] DWP, *Personal accounts: a new way to save*, Cmnd 6975, December 2006

[153] *The Personal Accounts Delivery Authority Winding Up Order 2010* (SI 2010 No. 911)

[154] Explanatory Memorandum

[155] *Pensions Act 2008*, section *75-7*; Dep 2008-0265

[156] See Dep 2008-0265 for a note on the proposed operation structure provided to members of the Public Bill Committee when the legislation was before Parliament.

[157] *Pensions Act 2008* , section 75 (3). *Pensions Act 2008 – Explanatory Notes*, para 180

[158] PBC Deb, 31 January 2008, c338

[159] PADA Press Release, *PADA welcomes the appointment of Deputy Chair Designate and Trustee Members Designate of NEST Corporation*, 25 March 2010

[160] Debates on such issues in Parliament are covered in Library Standard Note SN/BT 2141 *Pensions Bill 2007-08 – debates in Parliament*

[161] Explanatory Memorandum to the *National Employment Savings Trust Order* (SI 2010 No. 917), para 4.1

There are also scheme rules providing more detail about how the scheme is to be run. These are not subject to a formal parliamentary procedure but must be compatible with the Order and cannot be made about certain provisions of the scheme.[162] In debate in Parliament, the then Pensions Minister, Mike O'Brien, explained that the Government considered the arrangements for scheme rules to achieve a balance of independence and accountability:

> The scheme rules will include much of the day-to-day detail of how the personal accounts scheme will be run—hence the trustee body needs to have a high degree of independence in making the rules. However, the scope of the rules will be limited by the parameters set in the scheme order, which we have previously been discussing and will be subject to parliamentary scrutiny. That approach to the rule gives Parliament control of the scope of personal accounts but allows the trustee independence in the day-to-day administration and operation of the scheme.[163]

Under the *Pensions Act 2008*, the Secretary of State is responsible for establishing the first set of rules.[164] The NEST Rules were published on 25 March 2010.

There was consultation on both Rules and Order prior to publication.[165] Changes made following consultation are summarized in a 'Note to accompany the rules of the National Employment Savings Trust' published on 25 March 2010'.

Modifications to existing legislation, to make it appropriate to NEST, are made by the *Application of Pension Legislation to the National Employment Savings Trust Corporation Regulations 2010* (SI 2010 No 8):

> [...] `for instance disapplying the requirement to have member-nominated trustees, as this is not considered appropriate for a scheme of this nature, and providing that the requirements of "trustee knowledge and understanding" – a knowledge of the scheme's documentation, such as the Order, Rules and Statement of Investment Principles, and of trust and pension law – apply to the trustee of the scheme.[166]

Consultation of members and employers

The legislation requires the NEST Corporation to make and maintain arrangements for consulting scheme members and employers about "the ongoing operation, development and amendment of the scheme. This is to include the establishment of members' and employers' panels to act as a conduit for gathering opinion and will ensure that both members' and participating employers' interests are taken into account in the running of the scheme. It is also the intention that the members' panel will nominate one third of the trustees.[167]

In debate in Parliament, the then Opposition Pensions Spokesperson, Nigel Waterson, questioned whether the Secretary of State should have a role in determining the composition and functions of the panels. He also emphasised the importance of the employers' panel which, he said, should have equal status with the members' panel.[168] In response, the then Pensions Minister, Mike O'Brien, emphasised that the members' and employer's panel would play an important part in engaging with participants in the scheme.[169]

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[162] *Pensions Bill 2007-08* – Explanatory Notes [Bill 50-EN], para 137
[163] PBC Deb, 31 January 2008, c337; See also letter to members of Public Bill Committee Dep 2008-0265
[164] *National Employment Savings Trust Order 2010 (SI 2010 No. 917) Explanatory Memorandum*
[165] DWP, *Pensions – consultation on draft scheme order and rules*, 28 April 2009
[166] Explanatory Memorandum
[167] *Pensions Act 2008*, section 69
[168] PBC Deb, 31 January 2008, c316
[169] Ibid, c317

Regarding the role of the Secretary of State in setting the broad composition and functions of the panel, he argued that Parliament and Government had a "legitimate interest in ensuring there is a broad approach to employer and member engagement."[170] The role of the panels would be:

> Watching the decisions being made by the trustees board and ensuring the trustee is acting in the interest of the members and that investment decisions, the management, the operation, the procedures, the processes of collection and administration and payment are all ones which are in the interests of the members.[171]

The members' panel would be a "way of getting soundings." However, the responsibility for final decisions must lie with the trustees.

The Government argued that employers panel should not be represented on the trustee corporation because:

> All the individuals who form the corporate trustee will have the sole obligation to act in the members' best interests, rather than representing employers or any other particular interest group. It will not be possible for the trustee to meet its duty of acting in the members' best interests without taking account of employers' concerns, but it is not appropriate to appoint members of the trustee with this as a specific role or indeed in any sort of representative capacity for the employers.[172]

Details of how the members' and employers' panels should be set up and run are in Part 2 of *The National Employment Savings Trust Order 2010* (SI 2010 No. 917).

Auditing

An issue raised during Parliamentary debate was the auditing arrangements that would be put in place for the NEST scheme.[173] The Institute of Chartered Accounts in England and Wales (ICAEW) was concerned that a scheme of this kind could not be audited within the rules applying to occupational pension schemes. What would be meaningful, it argued, was for a third party to check that the administration is conducted properly.[174] In debate in the House of Lords, the then Parliamentary Under Secretary of State, Lord McKenzie, explained that the Government had concluded that the approach suggested by ICAEW was the right one.[175] It was the intention that the trustee corporation should establish an internal controls committee reflecting best practice in corporate governance.[176]

4 Further information

Pensions Commission

Pensions Commission, *Pensions: Challenges and Choices: the First Report of the Pensions Commission*, 12 October 2004,

Pensions Commission, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission*, 30 November 2005,

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[170] Ibid, c318
[171] Ibid, c323
[172] PBC Deb, 31 January 2008, c320
[173] PBC, 31 January 2008, c307 [Nigel Waterson]
[174] Ibid, c309
[175] HL Deb, 2 July 2008, c271
[176] HL Deb, 7 October 2008, c216

Pensions Commission, *Implementing an integrated package of pension reforms:The Final Report of the Pensions Commission*, 4 April 2006

Department for Work and Pensions (DWP)

Information about DWP's pension reform programme in 2007/08 can be found on the national archives website.

Of particular relevance to NEST are:

DWP, Security in retirement: towards a new pensions system, Cm 6841, May 2006

DWP, *Personal accounts: a new way to save*, Cm 6975, December 2006

Paul Johnson, David Yeandle and Adrian Boulding, *Making automatic enrolment work. A review for the Department for Work and Pensions*, October 2010

The main legislation is in:

Pensions Act 2007 and Explanatory Notes

and

Pensions Act 2008 and *Explanatory Notes*

Information about the work of the National Employment Savings Trust – including consultation documents and the NEST Scheme Order and Rules- can be found on its website.