Work and Pensions Select Committee inquiry into pensions auto enrolment

A response from NEST

About NEST

NEST is a trust-based defined contribution (DC) pension scheme that UK employers can use to meet the new workplace pension duties set out in the Pensions Act 2008. NEST is designed to be an easy-to-use, low-charge scheme. It was set up by government and has to accept all employers of any size that want to use it to comply with their duties.

At the time of publication NEST is working with over 50,000 employers and has over 2.6 million members. It’s delivered at no cost to the employer, in line with the original policy intent. A key aim of the scheme is to provide members the benefits of a good value, quality workplace pension scheme, whoever their employer and however much they save.

Executive summary

NEST is pleased to contribute written evidence to the Work and Pensions Select Committee inquiry into auto enrolment. In our response we wish to emphasise the following points:

- The introduction of auto enrolment has been a success to date. The Pensions Commission sought to boost pension participation in the UK, and early indications suggest that auto enrolment is achieving this goal.
- NEST, a key component of the commission’s recommendations, has played a vital part in the success of auto enrolment to date. Just over three years into the policy’s implementation, NEST has over 2.6 million members and is working with over 50,000 employers.
- At this stage only around 5 per cent of employers have staged, and NEST is mindful of the upcoming challenge for small and micro employers, as well as pension providers. We’re ready for this challenge and have made innovations to our product to simplify and automate the journey for small and micro employers.
- Our confidence in meeting this challenge has been bolstered by initial findings from the group of small and micro employers who staged in 2015. Over 4,000 of these employers used NEST, and results from our analysis show that employers in this group are less likely than larger employers to contact us directly, implying they’re successfully self-serving online, either on their own or via an intermediary. They were also less likely to use their waiting period, getting on with auto enrolment without delay.

In addition to the enrolment of small and micro employers, the committee asked about the suitability of minimum contribution rates.

- While NEST recognises that an 8 per cent contribution is a good start, many but not all savers will ultimately need to save more over time if they’re to achieve the retirement income levels they aspire to.
- We look forward to working with government and industry over the coming year to input into developing thinking on savings adequacy. We need to find ways of encouraging many savers to increase contributions, while managing the risks of over-saving by low earners, and of any increase in minimum contributions driving opt outs.
- Finally, the committee asked for input on the interaction between auto enrolment and the pension freedoms.
NEST welcomes the flexibility offered to consumers by the Freedom and Choice reforms, but in its role as a Trustee has thought seriously about the risks and potential detriment to members who, for whatever reason, cannot or do not make optimal choices at retirement. The future of retirement, an income blueprint for NEST’s members (PDF) sets out the product features we think our members will need access to. NEST’s blueprint harnesses flexibility, by incorporating drawdown and cash elements, while providing a regular income and risk profile we expect to suit a large proportion of NEST members.

We believe that government and industry need to work together to encourage the development of products like this, and to facilitate the development of advice and guidance frameworks that easily enable members to be routed towards them, in a way that limits the risk exposure to both member and provider.

Further to this point, we’ve provided the committee with a copy of The future of retirement, an income blueprint for NEST’s members and responded to the Financial Advice Market Review (FAMR) consultation.

A policy success

The introduction of auto enrolment has been a success to date. The policy was introduced to address a decline in participation in workplace pension schemes in the early 2000s, and promote saving that would enable people to build towards an adequate retirement income. Three years since its implementation, this decline is being addressed with close to six million people now participating in a workplace pension scheme and opt out levels currently exceeding initial expectations.

There’s much we can learn from the model of policy development which led to the implementation of auto enrolment. The creation of a policy conceived of by an independent commission and supported by a broad stakeholder consensus has led to a durable policy settlement. While there have been tweaks and revisions to the settlement over time, the main elements of the commission’s recommendations are being implemented.

The commission concluded there was strong potential for market failure if all employers were required to enrol their employees, as much of that business would be unprofitable to industry if delivered free to the employer. Consequently, the creation of a scheme with a public service obligation was required.

This has been borne out in practice, for example 35 per cent of NEST’s employers who joined during 2014 said that providers they approached were unwilling to enrol their entire workforce; and 40 per cent of independent financial advisers (IFAs) said pension providers would not write schemes for one or more of their businesses.

True to the original policy intent, NEST offers members the benefits of a good value, quality workplace pension scheme, whoever their employer and however much they save, and is free for employers to use. And importantly, NEST’s low charge model has helped to set a benchmark for both new entrants to the market, and existing providers in setting their charges.

The challenge of staging

Auto enrolment is rolling out as expected, with close to six million people enrolled into a qualifying scheme to date, accounting for a large number of the UK’s eligible workforce. However, the number of employers who’ve reached their staging date only accounts for around 5 per cent of the UK employer population. The next few years will be crucial in determining the success of the auto enrolment programme, as over a million small and micro employers reach their staging dates.

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As the chart shows, in quarter four 2015/16 we entered into a period of high volume staging. NEST has already managed over 100,000 members joining in a month. We now have on average over 500 employers signing up to NEST every single working day, that’s more than one per minute. These numbers will increase significantly as we head towards 2017 and 2018. Reported employer satisfaction levels have remained high as we’ve taken on these volumes.

Because of its public service obligation, NEST has been designed to deal with the scale and complexity of this challenge from day one. All the required systems, processes and capacity are in place to make it work, and can be flexed as necessary. On the employer side we’ve introduced a series of innovations to our product that make the journey as simple as it can possibly be, such as integration with payroll and the introduction of multi-client portals for intermediaries.

The small employer journey

Small and micro employers are fundamentally different to their larger counterparts, both in their size and the way in which they conduct their day-to-day affairs. Research conducted by NEST in 2014 showed that few small and micro employers are likely to have in-house pension systems. Indeed, of those surveyed¹:

- only 26 per cent currently offered any form of pension provision
- 73 per cent dealt with human resource issues without any external assistance
- just 55 per cent managed payroll completely in-house.

Because we know that setting up a pension will seem a big step for many small employers, we’ve designed the customer journey to be as automated and intuitive as possible and flexible enough to meet the needs of employers who wish to use us directly, via their payroll software or through an intermediary, such as an accountant, book-keeper or IFA.

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We’ve also listened to, and learned from, our employers and their intermediaries to continuously improve how our services work for employers.

Using NEST via our website

For those employers, or their intermediaries, who wish to use NEST via our website we’ve developed simple core journeys to set up, enrol members and pay contributions.

As of March 2016, we’ve a default journey for employers who wish to set up a scheme in line with the minimum legal requirements. We only need to capture basic information about the company, a bank account from which they want to pay contributions and confirmation of how often they intend to pay contributions to NEST.

This data should take no more than a few minutes to enter, and after which they’re able to set up a compliant scheme through a single confirmation click.

Similarly, enrolment and making contributions can be carried out through straightforward data entry, or by uploading files that may be produced out of basic payroll software. For the many employers, where contributions remain consistent, they can also use our copy function which enables them to make contributions by repeating the previous period through a few confirmation clicks.

Integrating with payroll software

Recognising that not all employers are the same, and learning from the experiences of the real time information (RTI) roll out, we’ve also developed integration with payroll software through NEST web services. Working with a number of the leading providers of payroll software in the UK, including Sage, IRIS, QTAC and Moneysoft, we’ve developed a solution that enables an employer or their intermediary to send information direct to NEST from within their payroll.

This solution enables an employer to set up their scheme with NEST, enrol members, send us contributions data and the instruction to pay all via a secure web message, similar to the HM Revenue and Customs (HMRC) RTI approach. It also offers a number of enquiry functions that can return useful information to an employer to help them run their scheme, such as refunds that have been received or outstanding contributions.

Offering both a streamlined online journey and a fully integrated payroll solution, we believe that NEST is offering a simple experience to the small employer whichever way they wish to engage with us.

Supporting the intermediary

In addition to how we’ve tailored our services for the small employer, we’ve recognised, through our research and learning from our employers, the importance that intermediaries will play with these employers, particularly accountants and payroll bureaux. As a result, we’ve a portal for these organisations called NEST Connect, which allows them to manage multiple employers through a single dashboard. It’s proving very popular, with over 5,000 intermediaries using the service. Currently over 13,000 employers have signed up to NEST via an intermediary using NEST Connect. We expect this to increase substantially as employer volumes increase over the coming months.

Lessons for NEST

NEST and other providers gained an insight into how employers might react via the group of small and micro employers who staged in 2015, ahead of the large volumes yet to stage. This presented NEST with an opportunity to understand how future small and micro employers might behave and, in turn, helped NEST to prepare and plan for the large volumes of employers due to stage over the coming months.

Crucially, this group of small and micro employers has the same breakdown of sizes and spread of industries as those due to stage in 2016 and 2017. This enabled NEST to identify three key behaviours and insights, as set out below.
1. Smaller employers tend to have simpler worker set-up and payment processes than their larger counterparts and as a result are likely to set up with just one group of workers, and one payment source. They’re far less complex.

2. Smaller employers are less likely to use their waiting period, compared to their larger counterparts. Almost half (44 per cent) of the employers that staged in the summer of 2014 enrolled their first workers in the three month period after their staging month, indicating that many were using waiting periods to postpone their duties. This reduced to 29 per cent for small employers and 26 per cent for micro employers, indicating that they’re getting on with auto enrolment without delay.

3. Small and micro employers are able to set up and use NEST with less need to call us than the employers that staged in the summer of 2014. When comparing the sign up and initial set-up process, small and micro employers say they call us about half as much as 2014 stagers. When asked, 27 per cent of small and micro employers say they didn’t call at all. Calling is even less likely among micro employers, with 41 per cent claiming they didn’t need to call NEST. In a survey of small and micro employers conducted by NEST, a significant majority (72 per cent) say they expect to rarely or never call NEST in the future. In fact, our qualitative research suggests that in the future most expect managing auto enrolment to be very easy and not time-consuming.

**Beyond the challenge of staging**

The most significant challenge in UK pension policy over the coming years will be effectively on-boarding over a million employers into a high quality, compliant auto enrolment scheme. However, as much as auto enrolment is about increased participation, the act of pension saving is fundamentally about building an adequate retirement income.

Auto enrolment is a good start to achieving this. As a result, many people can begin to look forward to a meaningful pension income where they wouldn’t have had one before. However, at present, minimum contributions are at just 2 per cent, rising to 8 per cent by the end of phasing. While we recognise that 8 per cent is a good start, many although not all savers will ultimately need to save more over time if they’re to achieve the income levels they expect.

We look forward to working with government and industry over the coming year to input into developing thinking on savings adequacy. We need to find ways of encouraging many savers to increase contributions, while managing the risks of over-saving by low earners, and of any increase in minimum contributions driving opt outs.

**The transition from saving to retirement**

NEST welcomes the flexibility offered to consumers by the Freedom and Choice reforms, but in its role as a Trustee has thought seriously about the potential detriment to members who, for whatever reason, cannot or do not make optimal choices at retirement.

The government has sought to smooth the transition to retirement for savers through the delivery of the Pension Wise service as well as seeking to close the advice gap through the Financial Advice Market Review (FAMR).

NEST welcomes both of these initiatives, but would emphasise that the weight of evidence suggests that even where advice is available and affordable, many may still fail to access it. And where people do take advice, it can only take them so far. Especially in simplified form, advice will not be sufficient to enable most people to fully understand the complex choices they currently face at retirement.

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3 Telephone survey of small and micro employers conducted by Bright Blue on behalf of NEST between 15th and 30th October 2015. 300 small and micro employers were interviewed. All employers were using NEST and had made their first payment to NEST between May and September 2015.

4 NEST conducted 20 qualitative interviews with 20 small and micro employers in August 2015. All the employers interviewed staged in June 2015 and had made their first payment to NEST.
Most drawdown products currently on the market require individuals to actively manage their investment throughout retirement. We know that only a small minority of savers will feel confident making these types of decisions, and that even where they feel confident, individuals actively managing investments on average tend to fair worse than those relying on defaults. We also know that capacity for this type of decision making declines with age.

Particularly in a fiduciary context, it’s contingent on trustees to ensure that members are routed towards products underpinned by a robust investment framework that offer good probabilities of strong outcomes across a wide range of circumstances, without a requirement for active management on the part of the member.

Our view is that NEST members will need access to products like the one described in The future of retirement, an income blueprint for NEST’s members which we published earlier this year, and which we’ve shared with the committee. The NEST’s retirement income blueprint is designed to provide a high degree of flexibility in the early years of retirement by incorporating drawdown and cash elements while securing a regular income in the later years. It offers a risk profile we expect to suit a large proportion of NEST’s members, with no requirement for active management.

Crucially, we believe there’s a role to play for fiduciaries such as pension scheme trustees not only in helping members find their way into the retirement income market, but potentially in overseeing the actual management of those products, for example through the dynamic management of drawdown rates and indexation to help mitigate the risk of running out of money. These are risks that in the traditional drawdown market are either addressed with ‘set and forget’ drawdown profiles which don’t respond to changes in circumstance, or by individuals seeking often costly advice on multiple occasions to make their own drawdown decisions. Extending drawdown to the mass market might require a different approach.

We believe products like the one described in the blueprint, governed in the right way, could be suitable for signposting via basic forms of guidance and advice, or even as a default pathway for those who fail to engage at all. Such products are therefore a critical component of making the Freedom and Choice reforms a success for all pension savers.

Conclusion

Auto enrolment has been a success to date. Nearly six million people have been enrolled into a qualifying scheme with opt out levels surpassing all expectations. This is a good start and should be celebrated as such. However, the coming years will prove the real acid test as over a million employers reach their staging date. Through research-based, innovative product design NEST has developed an employer journey which we believe makes the task of enrolling employees very simple and straightforward. We’re up to the challenge of the next phase of auto enrolment and look forward to taking the committee through our plans in greater detail.