EXPLANATORY MEMORANDUM TO

THE APPLICATION OF PENSION LEGISLATION TO THE NATIONAL EMPLOYMENT SAVINGS TRUST CORPORATION REGULATIONS 2011

2011 No. 673

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 This instrument adapts existing requirements on occupational pension schemes in relation to disclosure of information and borrowing to make these requirements effective in the context of the unique nature and scale of the National Employment Savings Trust (NEST).

2.2 The changes in relation to disclosure of information require the NEST Corporation, as trustee of the NEST scheme, to provide generic information on the contributions that are payable to the scheme by employers and by or for members of the scheme, and also alters the information that the scheme and its auditor must provide annually about employer-related investments.

2.3 The changes in relation to borrowing permit the NEST Corporation to borrow, but only for the specific purposes of meeting the costs of establishing, administering and managing the scheme and, if necessary, to provide cash-flow (also called liquidity) for the scheme on a temporary basis.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None

4. Legislative Context

4.1 The 2008 Pensions Act obliges employers to automatically enrol eligible workers into a suitable workplace pension scheme. NEST has been set up to support employers in fulfilling these duties and will be available to any employer who chooses to use NEST to do so.

4.2 NEST Corporation intends to launch the scheme in spring 2011 to test the scheme's administration and systems ahead of the intended commencement of the new employer duties from October 2012.

4.3 NEST will operate, as far as is appropriate, like any other trust based defined contribution occupational pension scheme and will operate, broadly, within the same legal boundaries. There are, however, some areas of existing pension legislation that would not be effective given the unique nature and scale of the NEST scheme.

5. Territorial Extent and Application

This instrument applies to Great Britain (this means England, Scotland and Wales).

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

What is being done and why

7.1 The current Occupational Pension (Disclosure of Information) Regulations (1996/1655) require a scheme trustee to provide information to members, beneficiaries, recognised trade unions and others regarding how employer contributions are determined and how member contributions, if any, are calculated.

7.2 Unlike other schemes, NEST is expected to have up to a million employers, and each employer can decide the basis on which contributions to NEST will be payable, providing the employer satisfies the quality criteria that are set out in the Pensions Act 2008 (section 20) for a money purchase scheme. The quality criteria for money purchase schemes such as NEST, require that the total amount of contributions paid by the jobholder and the employer, however calculated, must be equal to or more than 8% of the jobholder's qualifying earnings. Most occupational pension schemes are set up with specific terms and conditions agreed between the employer and scheme, and the rules of the scheme set out the basis on which contributions will be made by the employer and member.

7.3 The NEST scheme Rules are not, and cannot be, specific about how contributions for each and every employer and member are determined or calculated. Where a member is employed by an employer taking part in the scheme, only the employer will hold this information and NEST Corporation will not need the information in order to run the scheme. Where a member has no employer, then NEST Corporation must accept whatever contributions the member notifies he/she will make.

7.4 This instrument therefore changes what information NEST Corporation is required to provide about the contributions that are payable to NEST by employers, and by (or for) members of the scheme.

7.5 Where a member is employed by an employer taking part in the scheme, NEST Corporation is required to provide general information about the contributions that the member and employer are required to pay under the Pensions Act 2008 and the NEST Order and rules. Where a member is not employed by an employer taking part in the scheme, NEST Corporation is required to provide information about the contributions that are to be paid by (or for) the member. NEST Corporation must also provide information on any limit on the maximum amount of contributions that may be paid to the scheme, by or for a member. To support this generic provision, NEST Corporation has agreed to encourage employers to provide more specific information to members. NEST guidelines and tools on their website will help employers to provide this information.

7.6 The instrument also modifies the information NEST Corporation must provide about scheme assets that have been invested in employer- related investments.

7.7 Under the Occupational Pension Schemes (Investment) Regulations 2005 (2005/3378) investment in any one employer (including any person connected with, or an associate of, the employer), is restricted in all schemes to no more than 5% of the scheme's resources. This cap is designed to protect members' pension funds from the scheme over-relying on one employer's financial performance (or that of anyone associated or connected with the employer). This provision will apply to NEST Corporation.

7.8 The Occupational Pension (Disclosure of Information) Regulations (1996/1655) require schemes to set out in their annual report how much is invested in all employer-related investments. Most trust-based schemes have a direct link with their employer and/or have been set up to serve a particular industry or sector. This makes it relatively straightforward for the trustee (and fund managers) to identify and show annually employer-related investments (including where the scheme has invested in persons associated or connected with an employer). However, there will be no such direct link between NEST Corporation (the trustee) and employers taking part in the scheme.

7.9 NEST is likely to have up to one million participating employers and for NEST Corporation (or its fund managers) to identify and disclose all employer-related investments would be impractical. NEST has been established by Government as a low cost scheme for low to moderate earners. Identifying all employer-related investments for disclosure in the annual report could add significantly to the cost of operating the scheme, adding complexity that would make NEST harder to administer and undermining NEST's ability to deliver a low-cost pension proposition. In addition, because NEST has such a large number of participating employers, the potential for investment in a single employer to add risk to the scheme's investment portfolio is of a different order to a scheme with a single sponsoring employer or a scheme with a number of sponsoring employers whose activity is focussed in a particular economic sector.

7.10 To demonstrate that NEST Corporation's investment strategy will be such that scheme resources will be appropriately diversified, the instrument therefore requires NEST Corporation to disclose its one hundred largest investments in the annual report, and to show which of these investments are with employers taking part in the scheme.. The instrument also requires NEST Corporation to disclose, like all other occupational pension schemes, employer-related investments where these exceed 5% of the scheme's resources, what plans they have in place to reduce the excess and the timeframe involved in reducing the excess. The instrument does not require NEST Corporation to identify where investments are associated or connected with employers who take part in the scheme.

7.11 The instrument makes similar changes to the Occupational Pension Schemes (Requirement to obtain Audited Accounts and a Statement from the Auditor) Regulations (1966/1975), about showing employer-related investments in the auditor's annual accounts.

7.12 The Occupational Pension Schemes (Investment) Regulations 2005 (2005/3378) also prohibit borrowing by large occupational pension schemes for any purpose except on a temporary basis to help with cash-flow.

7.13 Unlike other pension schemes, NEST does not have a sponsoring employer who would normally fund the scheme set-up costs, nor does it have access to group capital like an insurance provider. As a consequence, until NEST and its revenue flows from member charges are established, the scheme will rely on borrowing to meet its set-up and early years' running costs. As a result of the nature of the risks involved in establishing NEST as part a broad programme of public policy reform, the Government will act as lender until NEST is established.

7.14 This instrument therefore allows NEST Corporation to borrow for the specific purpose of meeting the costs of establishing, administering and managing the NEST pension scheme and, if necessary, to provide temporary cash-flow for the NEST pension scheme.

Consolidation

7.15 Informal consolidation of this instrument will be included in due course in the Department's "the Law Relating to Social Security" (the Blue Volumes). These are free on the internet at: http://www.dwp.gov.uk/publications/specialist-guides/law-volumes/the-law-relating-to-social-security/

8. Consultation outcome

8.1 A public consultation on the Disclosure of Information: Proposed Amending Regulations ran from 6 January to 1 March 2010 and included several adaptations to existing regulations in relation to the NEST Corporation. The Association of British Insurers, Mercer, Standard Life and Society of Pension Consultants all felt that these did not result in a level commercial playing field and the adaptations were not taken forward. The consultation and the response to this consultation are published at:
http://www.dwp.gov.uk/docs/pen-scheme-disclosure-consultation-jan2010.pdf
http://www.dwp.gov.uk/docs/pen-scheme-disclosure-consultation-response.pdf

8.2 An informal consultation on the revised disclosure proposals covered by this instrument was undertaken with these stakeholders in February 2011. They all considered that the revised disclosure proposals were reasonable and proportionate.

8.3 A full public consultation ran from 9 December 2010 to 3 February 2011 on the proposed amendments to the borrowing provisions in the Occupational Pension Schemes (Investment) Regulations 2005 (2005/3378). Of the five responses received:

- one supported the proposal
- two had no comments
- one asked for a change, and
- one was against the proposal.

8.4 One respondent accepted the change was needed, but was concerned about NEST Corporation's funding arrangements and asked for a change to say that differential interest rates should be chargeable on particular elements of the loan.

8.5 As the Occupational Pension Schemes (Investment) Regulations 2005 (2005/3378) don't cover what interest rates can be charged on any borrowing by pension schemes, this request was beyond the scope of the consultation and was not accepted.

8.6 Another respondent considered that Government, 'in effect ... a quasi-sponsoring employer', should pay the set-up costs of NEST; that other pension schemes could challenge the advantage of NEST Corporation's borrowing powers; and that any greater ability or scope of trustees to borrow funds should be discouraged.

8.7 The Government believes that it is necessary to establish NEST to ensure that all employers are able to comply with their duties to automatically enrol jobholders into a workplace pension. Alternative means of funding the establishment of NEST were considered but were not considered practical. It should be noted, in particular, that Government meeting the costs of establishing NEST in full is unlikely to be compatible with European Directives on competition and state aid.

8.8 We have taken account of all responses and have not made any further amendments to the instrument. The response to the consultation will be published on the DWP website around the same time that the Regulations are laid in mid-March at: http://www.dwp.gov.uk/consultations/2010/nest-regs-2011-consultation.shtml

9. Guidance

9.1 There are no plans to introduce guidance as the changes mainly relate to NEST.

10. Impact

10.1 An impact assessment has not been produced for this amendment, because it does not impose extra rules on the private or voluntary sectors or individuals. An impact assessment for the Pensions Act 2008 set out the impact of establishing NEST. The 'Making Automatic Enrolment Work' review, which reported in October 2010, also considered the potential impact on the pensions industry, employers and individuals before making its recommendation that NEST should go ahead.

11. Regulating small business

11.1 These amendments do not impact on small business.

12. Monitoring & review

12.1 We will keep the changes under review to ensure they are working, as part of the Department's plan to monitor the impact of NEST and the wider workplace pension reforms. If any changes are needed, we will consider a further review.

13. Contact

13.1 Niall MacMahon at the Department for Work and Pensions Tel: 020 7449 7271 or email: niall.macmahon@dwp.gsi.gov.uk can answer any queries regarding the instrument.