INSTITUTE OF DIRECTORS RESPONSE TO CONSULTATION

NEST: Evolving for the Future

Department for Work and Pensions

"PUBLICLY OWNED PENSION PROVISION VERSUS COMPETITIVE MARKETS

NEST is a strange beast, borne of fears which never materialised. Do we really need a nationalised provider of pensions, which could distort free markets?"

Consultation Response

The Institute of Directors is pleased to have the opportunity to respond to this Call for Evidence from the Department for Work and Pensions. We would not propose to respond in detail to the questions asked in the accompanying paper, but would offer the following observations. This writer was closely involved in the Policy conversations which lead up to the constitution of NEST as we now have it and in the various Reviews which have attended its creation.

NEST was originally created by government in response to a specific fear around the policy of automatic enrolment (AE) of employees into pension saving. That fear was that the existing, and likely future roll of pension providers whether insured schemes or Master Trusts, would find it economically unattractive to serve very small and "micro" employers, and that the AE policy would fail as a result, or that those employers would only be served on expensive terms. It is true to say that not all market participants receive equal treatment in most markets; that is why "convenience" stores charge more than "superstores". However, that original fear proved unfounded and the range of active providers in the AE markets, including those prepared to serve very small employers, has been surprisingly wide. Pricing for this service varies; that is the nature of open, competitive and free markets. Some are charging fees, with differentiation potentially on service levels, others are not. Some solution providers have effectively chosen through pricing strategies to leave the market for small employers, others have not. This is only natural. NEST was given a service obligation at outset, to serve all employers, no matter how small or otherwise unattractive, at the same price. It was created as a national pension provider of last resort, to underwrite the AE policy. Whilst it is true to say that much pensions policy water has flowed under the bridge since 2010, and pensions "freedom and choice" would qualify as such a body of water, the fact remains that NEST was created to do a specific job. For a range of perfectly understandable, if potentially erroneously conceived, reasons, there is now in some quarters a wish to extend the remit of NEST into retirement income provision, access by individuals and bulk transfers. We would treat such moves with severe caution as the structure and position of NEST stand at present.

NEST is a very strange creature. It is, effectively, a nationalised pension provider, built with public money and, presumably, having access to more of such money to support it in future. It is not the place of this response to get into the economic debate about when its initial funding tranche will run out or what will happen when it does, but as an organisation we would intuitively start from the idea that there is no market so dysfunctional that government intervention cannot make worse, and this remains the case when considering expansion of NEST's remit. We would take the view that natural market forces have served to reduce charges and increase service levels elsewhere to a point where NEST's proposition to the market is arguably under some pressure. The economics of the organisation may also point towards the desirability of doing "more", but access to public funding may well have market-distortive effects. We can understand the wish to provide retirement income products in-house, rather than the annuity "panel" of outside providers on offer at present, and don't think this would be difficult for NEST to do – all that is really needed here is actually a payroll system – but other, external, providers are already offering such facilities. As NEST is a Defined Contribution scheme, the regulatory barriers to transfer are low. But it is the area of bulk transfers that we think there is the greatest potential for market damage. As the supporting paper recognises, the very narrow margins available on pensions business make profitable pensions operations a game of “scale”; of assets under management. Competition in markets means that larger schemes, with assets under management of an attractive level, will be offered low annual management charges (AMC) to transfer. This is markets working as they should. Any arbitrarily low AMC offered by a publicly funded body such as NEST in an effort to get “scale” would distort the market, potentially leading to the failure of some market participants and consumer detriment as a result.

To be clear, we think NEST has made a valuable contribution to the pensions market and has “done what it said on the tin” in providing a service to all the employers who have wished to use it. However, as history has turned out, with a plethora of private providers having entered all parts of the market, it’s probably a job which did not need doing. We therefore think that debating what else NEST might usefully, or otherwise, be tasked with doing represents the wrong question being asked. If it is to do any of these things, we think it should be with the disciplines of the free market behind it.

So, we think we need to be asking a deeper question around the future of NEST itself. We stand ready to debate this, and other matters around the evolution of the AE policy, as we move into 2017.

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SEPTEMBER 2016