Subject: State aid SA.36410 (2014/N) – United Kingdom
Modifications to the National Employment Savings Trust - NEST

Sir,

1. PROCEDURE

(1) On 6 July 2010, the European Commission adopted a decision approving the State support for the establishment and early years of operation of the United Kingdom’s (UK) National Employment Savings Trust (hereafter “NEST”) as compatible with the internal market under Article 106(2) of the Treaty on the Functioning of the European Union’ (hereafter “Original Decision”).

(2) On 25 March 2013, the UK submitted to the Commission a non-paper on the functioning of NEST and envisaged technical modifications to its set-up.

(3) On 10 April 2013, a meeting was held at the Commission’s premises in Brussels.

(4) On 23 April 2013, the UK submitted to the Commission an updated note on the proposed technical modifications to NEST.

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On 28 May 2013, the UK pre-notified to the Commission the technical modifications to NEST.

On 16 July 2013 and on 8 November 2013, the UK provided additional information to the Commission.

On 22 November 2013, a conference call was held between the Commission and the UK authorities.

On 8 January 2014, the UK formally notified the technical modifications to NEST.

On 10 February 2014, the Commission asked for further clarifications from the UK authorities, which the UK authorities provided on 31 March 2014 and on 19 May 2014.

2. DESCRIPTION OF NEST AND THE PROPOSED TECHNICAL MODIFICATIONS

2.1. Description of NEST and the aid measure

Under the UK pension reform\(^2\), employers are under a duty to automatically enrol workers into a pension vehicle. Automatic enrolment commenced in July 2012 with the largest employers and will end, with the smallest employers, in April 2017. Around 1.2 million employers are affected and around 10 million workers are eligible for automatic enrolment. So far over 3 600 employers have automatically enrolled around 2.2 million workers. NEST currently has over 650 000 members.

Research had shown that the market failed to sufficiently supply suitable products to small firms and individuals at lower earnings levels, which the market deemed not profitable enough. The UK thus created NEST aiming at serving low to moderate earners and those working for small and medium sized enterprises (SME) to make sure they can comply with the automatic enrolment\(^3\).

NEST has been entrusted with a Service of General Economic Interest (SGEI) to admit any worker automatically enrolled by their employer, even if the cost of administering the account is greater than the revenue derived from charges. NEST benefits from a subsidised loan from the Government to fill the costs and funding gap faced by NEST. Instead of paying commercial rates on the loan, NEST will pay the interest corresponding to the government's own cost of borrowing. The State aid consists in the difference of NEST's own refinancing terms and interest rate compared to the one received by the Government\(^4\).

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\(^3\) See Commission decision of 6 July 2010 for detailed description of NEST (recitals 25 – 40).

\(^4\) See Commission decision of 6 July 2010 for detailed description of the State aid measure (recitals 41 – 80)
By its decision of 6 July 2010, the Commission found that the measure was compatible under EU State aid rules and in particular with the 2005 framework for State aid as compensation for a SGEI.

2.2. Description of the proposed technical modifications to NEST

The technical modifications concern exclusively the design of NEST and do not concern the aid measure itself.

The initial design of NEST includes the following constraints (i) an annual contribution limit of maximum 3 600 GBP per individual, restricting the amount of contributions that an individual can make to the scheme and (ii) a general prohibition transfers to and from NEST (“transfer restrictions”).

The Pensions Act 2008 requires the UK to review the annual contribution limit and transfer restrictions on NEST in 2017.

Automatic enrolment started in 2012 for the larger enterprises. Based on the experience of its application thus far, the UK is concerned that the annual contribution limit and transfer restrictions are having, and will increasingly have in the coming years, a negative impact on the successful implementation of automatic enrolment and are preventing NEST from delivering its SGEI. Most SMEs consider that the restrictions do not enable them to choose NEST as their single pension vehicle. NEST becomes an unsuitable provider for SMEs, which are very reluctant to use it due to the administrative and cost burden of having to work with several schemes. The UK wants to ensure that employers find automatic enrolment easy and cost efficient to implement and make the right choices for their workers.

The UK notified to the Commission a request for a technical modification of NEST consisting in the removal of the annual contribution limit (on 1 April 2017) and of the transfer restrictions (on 1 April 2017 for bulk transfers and on 1 October 2015 for individual transfers subject to the approval of the UK Parliament).

All terms regarding the aid measure approved by the Original Decision remain unchanged and are not subject to any modification.

3. Position of the United Kingdom

The annual contribution limit and transfer restrictions were intended to help ensure that NEST focuses on its target market and provides administrative simplicity to the scheme. The expectation from stakeholders, including the pensions industry, was that the annual contribution limit and transfer restrictions would be lifted. The Pensions Act 2008 reflects this expectation requiring the UK Government to review the annual contribution limit and transfer restrictions imposed on NEST in 2017.

The UK is concerned that the constraints pose a risk now for NEST to deliver its SGEI. Responses to the UK Government’s call for evidence on the impact of the
annual contribution limit and transfer restrictions show that 83% of SMEs perceive these constraints as a barrier to accessing NEST. The evidence gathered also shows that, although the market has expanded in response to automatic enrolment, there is a supply gap for SMEs due to provider capacity issues and the likely lack of profitability of SME’s workforces.

(22) Automatic enrolment requires all employers to provide automatic enrolment to workplace pension provision by 2017. If SMEs experience difficulties implementing automatic enrolment because of these two constraints on NEST, it could undermine confidence in the reforms at a crucial time.

(23) So far over 3 600 large employers have automatically enrolled around 2.2 million workers in a pension scheme. The UK’s experience has shown that almost all large employers started preparation at least a year in advance. Fulfilling their automatic enrolment duties has been a significant logistical and administrative exercise for those employers. The inexperience of SME employers with pension schemes makes implementation timelines even more challenging for them. Given these implementation challenges, it is vital that NEST is seen as a viable option for SMEs.

(24) The UK is concerned that, due to these two constraints, SMEs will expend resources seeking alternative automatic enrolment provision but find they have no alternative to NEST very late in the preparation timetable. This would undermine its ability to deliver its SGEI effectively during the introduction of automatic enrolment and consequently damaging confidence in the pension reforms more generally.

(25) The UK plans to address this risk through communications to employers and intermediaries already in 2014. A key part of the message needs to be that these constraints will be lifted. Over 1 million SMEs will need to make scheme selection decisions until 2017. It is critical to the success of automatic enrolment that NEST is able to play its part in supporting the reforms and deliver its SGEI throughout this period.

(26) These constraints have an impact on employer choice but they also restrict the ability of individuals to save more into their pension or make transfers into and out of NEST. Lifting the constraints will allow the UK to build on the automatic enrolment reforms by encouraging higher contribution levels and tackling the proliferation of small pension pots that automatic enrolment is expected to generate.

(27) Lifting these two constraints will also give NEST members the same rights as members of other schemes from that point onwards. The UK anticipates that the impact on the market at that time will be limited as existing employers would have already chosen their scheme by then and are unlikely to switch schemes as a result of this change.

(28) The UK considers that it is necessary and proportionate to lift the annual contribution limit and transfer restrictions on NEST as the technical modification is the minimum change necessary to allow NEST to deliver its SGEI effectively.
(29) The modification only concerns two technical features of the design of NEST. The aid measure itself will, however, not be subject to any modification.

4. ASSESSMENT

(30) The proposed technical modifications to NEST, consisting of the removal of (i) the annual contribution limit of maximum 3 600 GBP per individual and (ii) the general prohibition of pension transfers to and from NEST, do not affect the aid measure itself but concern only the technical design of NEST, which is necessary to enable NEST to fulfil the SGEI obligations. Therefore, the removal of these two restrictions does not alter the terms and conditions of the aid measure approved in the Original Decision.

(31) The aid measure as approved in the Original Decision consists in the provision of a subsidised loan where the aid to NEST consists in the interest rate spread between NEST and the UK government and the UK confirms that it will not change the terms and the conditions of the loan agreement. The existence and the nature of the aid remain unchanged.

(32) Hence, for the reasons indicated in the Original Decision, the Commission still considers that the compensation granted to NEST in the form of a provision of a subsidised loan from the Government to fill the costs and funding gap faced by NEST constitutes State aid within the meaning of Article 107(1) TFEU.

(33) Since the proposed technical modifications do not affect the actual substance of the aid measure, the compatibility assessment of the aid measure in the Original Decision finding the aid compatible under Article 106(2) TFEU remains unchanged. None of the proposed technical modifications to NEST alters that assessment⁵.

(34) In particular, the compatibility assessment in the Original Decision concluded that (i) NEST is a SGEI; (ii) NEST is entrusted by an official act that contains all the elements of the SGEI; (iii) there is no overcompensation for the provision of the SGEI⁶.

(35) First, the proposed technical modifications are necessary for NEST to fulfil its SGEI. Therefore the assessment of the Original Decision qualifying NEST as a SGEI remains valid. Second, NEST remains entrusted by an official act containing all the elements of the SGEI. Third, the compensation mechanism for the provision of the SGEI remains unchanged, and none of the technical modifications is liable to

⁵ See judgment of the Court of First Instance in Joined Cases T-195/01 and T-207/01 'Government of Gibraltar v Commission of the European Communities' paragraph 111, where the Court stated that: 'Accordingly, it is only when the alteration affects the actual substance of the original scheme that the latter is transformed into a new aid scheme. There can be no question of a substantive alteration where the new element is clearly severable from the initial scheme'.

⁶ See recitals 120 – 151 of the Original Decision
have an impact on the functioning of the compensation mechanism. Hence the assessment of the Original Decision of absence of overcompensation remains unchanged. Accordingly, the proposed technical modifications to NEST do not alter the compatibility assessment of the Original Decision finding the aid compatible under Article 106(2) TFEU.

(36) Therefore the compatibility assessment in the Original Decision finding the aid measure compatible with the internal market under Article 106(2) TFEU remains unchanged.

5. CONCLUSION

The Commission has accordingly decided to continue to consider the aid to be compatible with the internal market.

If this letter contains confidential information which should not be disclosed to third parties, please inform the Commission within fifteen working days of the date of receipt. If the Commission does not receive a reasoned request by that deadline, you will be deemed to agree to the disclosure to third parties and to the publication of the full text of the letter in the authentic language on the Internet site: http://ec.europa.eu/competition/elojade/isef/index.cfm

Your request should be sent by registered letter or fax to:

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Yours faithfully,
For the Commission

Joaquín ALMUNIA
Vice-President