EXPLANATORY MEMORANDUM TO

THE OCCUPATIONAL AND PERSONAL PENSION SCHEMES (AUTOMATIC ENROLMENT) REGULATIONS 2010
2010 No. 772

THE EMPLOYERS' DUTIES (IMPLEMENTATION) REGULATIONS 2010
2010 No. 4

THE EMPLOYERS' DUTIES (REGISTRATION AND COMPLIANCE) REGULATIONS 2010
2010 No. 5

THE PUBLIC INTEREST DISCLOSURE (PRESCRIBED PERSONS)(AMENDMENT) ORDER 2010
2010 No. 7

1. 1.1 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 instruments

2.1 These statutory instruments set out the practical arrangements employers must make to automatically enrol eligible jobholders into a pension scheme, the arrangements for individuals who wish to opt out of pension saving and the minimum quality standard certain schemes must reach in order to be used by employers. They also set out the arrangements for implementing the new employer duties and the powers to enable the Pensions Regulator (TPR) to monitor and enforce compliance with the employer duties and safeguards. They also include an amendment to existing regulations which extends the due date by which employers have to pay over employee contributions deducted from salary to a pension scheme and an amendment to an existing order to make sure that if someone suffers detriment or is dismissed as a result of making a compliant to TPR, this is unlawful.

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

3.1 None

4. Legislative Context

4.1 The Pensions Act 2008 (the Act) provides powers to the Secretary of State to establish regulations that underpin the employer duties and the compliance regime outlined in the Act.

4.2 These statutory instruments are very closely linked in their purpose as together they form the basis of the pension reforms established for the first time under the Pensions Act 2008 and that is why they have been grouped.

4.3 Chapter 1 of Part 1 of the Pensions Act 2008 provides powers to the Secretary of State to:

- Establish the practical arrangements that an employer must make to automatically enrol an eligible jobholder into a qualifying scheme and pay a minimum contribution. The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations set out the processes and timings for automatic enrolment, opt out, automatic re-enrolment, voluntary opt in, the provision of certain information and the minimum quality standards for certain schemes.
- Establish in regulations the arrangements to implement the employer duties and to reduce burden on business by allowing employers to phase in the levels of contributions over time. This is achieved through the Employers' Duties (Implementation) Regulations.

4.4 Chapters 1, 2 and 3 of Part 1 of the Pensions Act 2008 provides powers to the Secretary of State to establish in regulations the compliance regime that underpins the employer duties. The Employers' Duties (Registration and Compliance) Regulations achieve this by outlining how employers register compliance with TPR, what records they will have to keep, when TPR can investigate certain breaches, certain details on some of the compliance tools available to TPR and the penalty levels that TPR can use.

4.5 A separate statutory instrument allowing TPR to delegate certain powers was laid on 20 July 2009 and came into force on 13th November 2009. Also, a statutory instrument establishing the National Employment Savings Trust pension scheme was laid on 12 January 2010. These statutory instruments are linked to this group as they establish the National Employment Savings Trust pension scheme aimed at low to moderate earners that employers can use to fulfil their duties outlined in these regulations and permit TPR to delegate certain functions to which the Registration and Compliance regulations relate to a third party.

5. Territorial Extent

5.1 This instrument extends to Great Britain. The Department for Social Development in Northern Ireland will be producing its own legislation replicating these regulations for Northern Ireland.

6. European Convention on Human Rights

6.1 The Minister of State**,** Angela Eagle, has made the following statement regarding Human Rights:

'In my view the provisions of the Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010 are compatible with the Convention rights.'

6.2 As the Employers' Duties (Implementation) Regulations 2010, the Employers' Duties (Registration and Compliance) Regulations 2010 and the Public Interest Disclosure (Prescribed Persons)(Amendment) Order 2010 are subject to negative resolution procedure and they do not amend primary legislation, no statement is required.

7. Policy background

- ***What is being done and why***

7.1 It is estimated that around 7 million people are currently not saving enough to deliver the pension income they are likely to want, or expect, in retirement with an estimated 44% of working age employees not contributing to a private pension.

7.2 The Enabling Retirement Savings Programme (ERSP) is one of the Government's key responses to the challenges facing the UK pensions system. It was set up by the Department in response to Lord Turner, Chairman of the Pensions Commission's report that millions of people are under saving for retirement.[1]

7.3 Following the Commission's recommendations, the Government response in the form of the White Paper *Security in retirement: towards a new pension system*, published in May 2006[2], set out a programme of State and workplace pension reforms which aim to increase an individual's income in retirement (the Government's response to this consultation was published in October 2006)[3].

7.4 These reforms are estimated to affect over 1 million employers with between 5-9 million people newly participating or saving more in all forms of workplace pensions.

7.5 The first part of this reform package was implemented through the Pensions Act 2007 which focused on changes to state pensions, and established the Personal Accounts Delivery Authority (PADA). The measures in the Pensions Act 2008 are aimed at providing security in retirement, including new duties on all employers to automatically enrol eligible jobholders into a pension scheme and pay a minimum contribution. They establish a compliance regime that will be delivered by TPR and set up a new low cost simple pension scheme.

7.6 The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010

7.7 The Pensions Act 2008 requires employers to automatically enrol eligible jobholders into a workplace pension scheme and pay set minimum contributions[4]. Individuals who do not want to participate in pension saving have the right to opt out and be treated as having never been a member of the scheme. The Act requires employers to re-enrol eligible jobholders who have opted out or left pension saving at regular intervals. The Act also provides those people not eligible for automatic enrolment with the ability to opt into pension saving voluntarily. Where an employer operates a higher quality scheme, the Act enables the employer to postpone automatic enrolment for a period of time.

7.8 The Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations set out the practical arrangements underpinning the automatic enrolment objectives of the Act.

---

[1] First report of the Pensions Commission – 'Pensions: Challenges and Choices', Chapter 4, Section 5 http://www.webarchive.org.uk/wayback/archive/20070801230000/http:/www.pensionscommission.org.uk/index.html

[2] White paper – Security in Retirement - http://www.dwp.go.uk/docs/white-paper-complete.pdf

[3] Government response - http://www.dwp.gov.uk/docs/pens-wp-response.pdf

[4] equal to 8% of gross earning between £5035 and £33,540 (2006/2007 terms)

7.9 The regulations outline the process and time limits for employers to achieve active membership for jobholders and the information flows required between employers, pension schemes and jobholders. The regulations also set out arrangements for employers who already operate a higher quality scheme to postpone automatic enrolment for 3 months if they wish to. The regulations outline the arrangements and time limits by which the employer has to re-enrol eligible jobholders who have opted out or left pension saving.

7.10 The regulations set out the process and arrangements where a jobholder chooses to opt out of pension saving, including the rules for refunding contributions. They also outline the arrangements by which jobholder and workers who are not eligible for automatic enrolment can voluntarily opt in to pension saving.

7.11 The regulations set out additional scheme quality requirements for:

- defined benefit pension schemes (schemes where the benefits provided at retirement are based on the member's service and earnings);
- hybrid schemes (intermediate schemes between those which provide defined benefits and those that are money purchase); and
- non-UK schemes (schemes that have their main administration outside the UK).

7.12 The draft rules for hybrid schemes have also been issued alongside the regulations for hybrid schemes for information and completeness. Guidance to assist employers and actuaries on the use of defined benefit and hybrid schemes will also be published in due course.

7.13 These regulations also include an amendment to The Occupational Pension Schemes (Scheme Administration Regulations) and the Personal Pension Schemes (Payments by Employers) Regulations 2000. This amendment extends the due date by which an employer must pay over employee contributions deducted from earnings to a pension scheme. The reason for this extension is to minimise the need for the scheme to refund contributions to the employer if the jobholder opts out by allowing the employer to keep the contributions until after the opt out period has passed.

7.14 These regulations also specify how TPR can determine that both employer and worker contributions are overdue for the purposes of issuing an unpaid contributions notice, which is a compliance tool that allows the regulator to seek to recover late or unpaid contributions.

7.15 **The Employers' Duties (Implementation) Regulations 2010**

7.16 The Pensions Act 2008 states that the employer duty to automatically enrol eligible jobholders into a pension scheme and pay a minimum contribution will not start until a date defined in regulations. The Act states that the duties will apply to employers on specific dates which are set out in regulations depending on the description of the employer.

7.17 The Act also states that the quality requirements for pension schemes may be introduced gradually over a transitional period. For money purchase schemes (schemes where benefits at retirement are based on how much is paid in and how the chosen investment performs) the Act allows employers to phase in the minimum contribution levels over two transitional periods with both periods lasting at least a year, and sets out the minimum contribution levels for each period.

7.18 For defined-benefit schemes (where the benefits provided at retirement are based on the member's service and earnings) and hybrid schemes (intermediate schemes between those which provide defined benefits and those that are money purchase), the Act enables employers to delay automatic enrolment until the end of a transitional period for those jobholders who have an existing entitlement to be in the pension scheme but have chosen not to join.

7.19 These regulations set out the details of how the employer duties will be staged in over time. They prescribe how employers will be defined, and describe which employers will be brought under the duties at each staging date. The regulations enable employers to bring forward their given date to an earlier date and set out the conditions that employers must meet in order to do this.

7.20 The regulations also prescribe the length of the transitional period for defined-benefit and hybrid schemes and the time periods for phasing in contributions in money purchase schemes.

7.21 **The Employers' Duties (Registration and Compliance) Regulations 2010**

7.22 The Pensions Act 2008 creates new obligations in terms of employer duties and safeguards. The safeguards are the prohibitions on an employer persuading or forcing a jobholder to opt out or leave pension saving and on forms of recruitment conduct that are intended to screen out job applicants who want to save in a pension. It is vital to create an infrastructure for enforcing these new obligations in order to protect individuals' access to pension saving and provide a level playing field for employers.

7.23 The Act also gives TPR an additional statutory objective to maximise compliance with the new employer duties and safeguards set out in the Act. To enable TPR to fulfil their objective, the Act allows the Secretary of State to make regulations requiring employers to provide information to TPR telling them how they have complied with their duties. TPR will use this information to identify and follow up on non-compliance. Employers and pension schemes are also required to keep certain records that will enable TPR to check compliance. Where non-compliance is detected, the Act gives TPR a range of discretionary powers to issue various kinds of compliance and penalty notices to enforce compliance.

7.24 The Employers' Duties (Registration and Compliance) Regulations set out the detail of what information employers have to give to TPR and the records an employer must keep, in what form and for how long. Following the implementation of the reforms employers will be required to give TPR certain information about action they have taken to meet the employer duties, and then update that information every three years.

7.25 The regulations also prescribe certain details around TPR's new discretionary powers to enforce compliance. Where the right contributions have not been paid, the regulations specify the rate of interest that may be applied, whether or not the employer may be asked to pay both employer and jobholder contributions and the method that TPR may use to calculate the amount outstanding.

7.26 The regulations set the levels of fixed and escalating penalties which can be applied by TPR where employers, and in some circumstances third parties, have failed to meet their requirements or have contravened measures in the Act. They prescribe the time within which recipients of compliance and penalty notices can seek a review of

those notices and within which TPR itself can initiate such a review. The regulations prescribe the time limits for enforcement action in cases where an employer has persuaded or forced a jobholder to opt out of or leave pension saving.

7.27 **The Public Interest Disclosure (Prescribed Persons)(Amendment) Order 2010**

7.28 This order amends the existing Public Interest Disclosure (Prescribed Persons) Order to make sure that any detriment or dismissal a person suffers as a result of making a complaint to the Regulator is unlawful. The amendment clarifies that such disclosures may be made to TPR in connection with TPR's new objective in the 2008 Act in addition to the existing protection for disclosures to TPR relating to occupational pension schemes and other private pension arrangements.

- ***Consolidation***

7.29 The regulations contain amendments to the Occupational Pension Schemes (Scheme Administration) Regulations 1996 and the Personal Pension Schemes (Payments by Employers) Regulations 2000. Both amendments refer to the date by which an employer must pay a person's contribution to the pension scheme (the 19 day rule). Consolidation is not appropriate in this case because each set of regulations deals with a different type of pension scheme: occupational schemes and personal pension schemes. Although the particular provision is very similar in both spheres, each regime should contain a separate provision relating to the 19 day rule. To consolidate would cause more confusion. If consolidation of the 19 day rule occurred a reader, instead of finding a complete picture regarding the scheme administration of occupational pension schemes, for example, in a single set of regulations, would have to refer to two different sets of regulations to obtain the same information.

8. Consultation outcome

8.1 The Department undertook a 12 week consultation on the draft Automatic Enrolment regulations from 12 March to 3 June.[5] It focussed on regulations associated with auto-enrolment including information flows, the prescribed arrangements for opt-outs and refunds and postponement. 79 formal responses were received from employer groups, pension providers, consumer groups and pension lawyers.

8.2 While the workplace pension reforms were broadly supported, there were strong reservations about this set of regulations. Stakeholders considered them too prescriptive and burdensome and judged the timescales to be too short. As a result of the consultation the Department sought to simplify processes and remove unnecessary prescription, lengthen timescales and align process for workplace pensions and personal pensions.

8.3 The Department then undertook a 6 week public consultation on the Workplace Pension Reform – Completing the Picture draft regulations, which ran from 24 September to 5 November 2009. This consultation included the remainder of the automatic enrolment regulations, the implementation regulations and the registration

[5] Consultation on Draft Regulations – The Pensions (Automatic Enrolment) Regulations 2009 and The Pensions Regulator (Delegation of Powers) Regulations 2009, 12 March http://www.dwp.gov.uk/docs/pensions-auto-enrol-regs2009.pdf

and compliance regulations. [6] 75 responses were received from pension providers, pension lawyers, consumer groups and employer groups.

8.4 A reduced consultation period was necessary due to elements of the employer compliance regime and the National Employment Savings Trust pension scheme being delivered by external suppliers and the need to provide as much certainty as possible about what suppliers need to deliver as soon as possible. This was in order to avoid the potential procurement costs associated with delaying certainty and changing the proposals at a later date.

8.5 To mitigate the shortened consultation period and ensure a thorough response the Department had a comprehensive stakeholder engagement strategy. This included holding around 40 meetings and workshops with stakeholder representatives before and during the consultation period, running employer seminars and carrying out qualitative research with 66 small and medium-sized employers. As a result, few stakeholders responded negatively to the shortened consultation window in their response.

8.6 32 specific questions were asked in the consultation document as well as general comment being invited on any of the proposals. Constructive suggestions across a number of areas were received and comments have resulted in relatively modest, or no, changes to the regulations included in these instruments.

8.7 However, there were a couple of more contentious areas:

- Whilst stakeholders generally understood the core operational drivers behind the implementation process, they were concerned about its length, complexity and inflexibility. Due to the operational constraints of implementing the reforms the Department is not able to reduce the length of the implementation process and on further consideration we feel that it is appropriate to provide further support to smaller and new businesses by bringing these companies under the duties slightly later, once larger firms have been staged in. This will be carefully handled with stakeholders through the Government response and going forward.
- Views on whether employers can postpone automatic enrolment for short-term workers were strongly polarised. However, there was a consensus that the proposed draft regulation to protect short-term workers would not meet the policy intent effectively. In response, we have amended the regulations to ensure that employers are able to use postponement for all eligible jobholders including short-term workers, but we have included a provision which will prevent employers from using serial short-term contracts to repeatedly postpone individuals.

9. Guidance

9.1 The Department is planning to signpost information about the reforms via an information hub and other Government portals. The hub is expected to provide information about automatic enrolment from 2011. The hub will be targeted at individuals, contain user-friendly, easy to understand information and may be accessed via a number of channels including the internet and via a telephone contact centre.

9.2 TPR will be responsible for the delivery of communications, education and guidance to employers, intermediaries and industry to support the compliance regime.

[6] Pensions – Consultation on Draft Regulations, Workplace Pension Reform – Completing the Picture, 24 September http://www.dwp.gov.uk/docs/workplace-pension-reform-completing-the-picture-consultation240909.pdf

This will include direct communications to employers prior to the commencement of their duties. Guidance will be provided by TPR to ensure that employers, and their intermediaries, know what they must do, how, and by when to comply with the employer duties and safeguards.

10. Impact

10.1 These reforms have an impact on all employers including charities or voluntary bodies that have eligible employees (those that are aged 22 and over, under state pension age and earning over £5,035 in 2006/07 terms). Businesses, charities and voluntary bodies will incur administrative costs of reform and of making minimum pension contributions for eligible employees. These costs are estimated in the Impact Assessment.

10.2 The impact of reforms will be different for the not-for-profit sector because they have less ability to cope with the reforms by increasing prices or freezing wages. However, pension provision in the not-for-profit sector with at least 3 per cent employer contribution is relatively high at 58%. Pension provision in the private sector is 39% in comparison.

10.3 The impact of these reforms on the public sector is discussed in the Impact Assessment. The impact on the public sector of the reforms is related to the costs of implementing the workplace pension reforms including the impact on the Exchequer of granting tax relief on higher individual and employer pension contributions, the impact on the Exchequer of expenditure on Income Related Benefits and the cost to public sector employers, as the new employer duties also apply to them.

11. Regulating small business

11.1 The legislation applies to small business.

11.2 Employers will be the key to ensuring the success of the workplace pension reforms and minimising burdens on employers where possible is a key reform commitment. There are a number of characteristics particular to small firms which mean that workplace pension reform could affect them differently from larger firms. The Government is aware of these challenges faced by small firms and are keen to see that they are not disadvantaged by the reforms.

11.3 Research has been undertaken specifically to understand how small employers will cope with the reforms under different economic scenarios. Representatives of small businesses have been consulted on the pension reforms - with regular meetings with the British Chamber of Commerce, the Federation of Small Business, the Confederation of British Industry and the Engineering Employers Federation throughout the last year, all of whom submitted written responses to the formal consultations. DWP has also been in regular contact with the Better Regulation Executive to seek their advice on engaging with and meeting the needs of small employers.

11.4 The implementation approach has been designed to help small employers adjust to the costs of reform gradually and minimise costs to small employers during the implementation period:

- Employers will be brought into the duties by size with large and medium-sized employers brought in first, followed by small and micro employers, giving small employers more time to smooth the costs of set-up;

- Minimum contributions will be phased in to help employers adjust to the additional costs gradually;
- To ensure that the compliance regime, communications approach and support for smaller employers works, a group of small employers will be required to automatically enrol their eligible jobholders into a pension scheme early on in the implementation process. Bringing them under the duties earlier will make sure that the needs of this group can be understood, and the approach tailored accordingly, before the majority of the small and micro employers become subject to the duties.

11.5 The costs to small employers as a result of the implementation approach are quantified in the Impact Assessment.

12. Monitoring & review

12.1 The programme intends to fully evaluate the effects of the reforms against the policy objective of getting more people to save more for retirement. We estimate that 5-9 million people will be newly participating or saving more in workplace pensions, and additional savings of up to £10 billion per year by 2017 will be generated.

12.2 We will also assess the impact of the reforms on employers and the pensions industry to evaluate the extent to which we meet this policy objective whilst putting minimal burden on employers and maintaining current good pension provision.

12.3 The effects of the reforms will be evaluated through analysing a range of data, including Management Information from TPR and the National Employment Savings Trust pension scheme, existing continuous surveys of individuals and employers run by DWP and other government departments such as the Office for National Statistics and where appropriate, research commissioned by DWP. As such, the evaluation will be conducted by a combination of external research organisations, academics and DWP analysts. The evaluation will be carried out on an on-going basis to gauge progress throughout the implementation of the reforms and beyond, and findings will be available publicly at key stages.

12.4 In addition to the evaluation of the reforms, in 2017 the Department will review those features of the National Employment Savings Trust pension scheme that are designed to focus it on the target market, specifically the annual contribution limit and the prohibition of pension fund transfers to and from the scheme. The evaluation of the reforms will feed into this review, as appropriate.

13. Contact

Nicola Sartain at the Department for Work and Pensions (Tel: 02074497260 or email: Nicola.Sartain@dwp.gsi.gov.uk) can answer any queries regarding the instrument.

Workplace Pension Reform Regulations

Workplace Pension Reform Regulations

Impact Assessment

12 January 2010

DWP Department for Work and Pensions

Summary: Intervention & Options

Department /Agency: Department of Work and Pensions	Title: Impact Assessment of Workplace Pension Reform for Pension Regulations 2010	
Stage: Introduction of Pension Regulations	Version: 1.0	Date: 12th January 2010

Related Publications: Impact Assessment of Workplace Pension Reform (automatic enrolment) regulations 2009 (consultation stage); Impact Assessment of Workplace Pension Reform (completing the picture) regulations 2009 (consultation stage); Pensions Bill-Impact Assessment April 2008

Available to view or download at:

http://www.dwp.gov.uk/pensionsreform

Contact for enquiries: Daphne White **Telephone:** 0207 449 7255

What is the problem under consideration? Why is Government intervention necessary? Millions of people in the UK are not saving enough for their retirement. There are a number of barriers which prevent people from making a decision to start saving for retirement and these affect low to moderate earners in particular. Most people have low financial literacy and tend to exhibit poor understanding of pensions and the benefits of saving for retirement. Even if people understand the need to save, they suffer from 'inertia' and do not get around to making the decision because current spending pressures seem more important than the future. At the same time employer provision of pensions is becoming less generous and although significant elements of the pension market work very well, there is a lack of suitable pension products for people on low to moderate incomes or working for small firms.

What are the policy objectives and the intended effects? The main objective of the policy discussed in this impact assessment is to enable low to moderate earners to save more for retirement. The policy measures considered in this Impact Assessment support reform to workplace pensions contained in the Pensions Act 2008 and meet each of the Government's five tests set out in the 2006 White Paper: to support personal responsibility and deliver fairness, simplicity, affordability and sustainability. The regulations are intended to improve individuals' outcomes in retirement by making it easier and more attractive to save while minimising burdens on employers and the pension industry.

What policy options have been considered? Please justify any preferred option. The Pensions Act 2007 enabled the introduction of a simpler, fairer and more generous State Pension system, funded by a gradual increase in the State Pension Age. On its own, however, the State Pension system will not provide the retirement income that many people want. Therefore, relying on state provision alone will provide retirement income that falls short of many people's expectations. Levels of private pension saving therefore need to increase.

Policy options specific to workplace pension reform regulations considered in this Impact Assessment have been previously considered in the two impact assessments published at the consultation stage of the regulations. The final policy approach has achieved a broad-based consensus amongst political parties, the public, businesses and the pensions industry that the reforms set out in these regulations constitute the most effective form of Government intervention.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects? The programme intends to fully evaluate the effects of the reforms against the policy objective of getting more people to save more for retirement in 2017. The evaluation will also assess the extent to which this policy objective is met with minimal burden on employers and the pension industry. In addition to the evaluation of the reforms, in 2017 DWP will review those features of the personal accounts scheme that are designed to focus it on the target market, specifically the annual contribution limit and the prohibition of pension fund transfers to and from the scheme. The evaluation of the reforms will feed into this review, as appropriate.

Ministerial Sign-off For final proposal/implementation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that a) it represents a fair and reasonable view of the expected costs and benefits and impact of the policy , and b) the benefits justify the costs.

Signed by the responsible Minister: *Angela Eagle* Date: 7 January 2010

Summary: Analysis & Evidence

Policy Option: Workplace Pension Reform	Description: **To encourage people to save more for their retirement**

COSTS

ANNUAL COSTS	
One-off (Transition)	**Yrs**
£ 0.3 billion	1
Average Annual Cost (excluding one-off)	
£ 12.9 billion	

Description and scale of **key monetised costs** by 'main affected groups'. The costs shown here are the average annual costs between 2012 and 2050 in present (2009/10) prices. These are the annual averages relating to figures presented in Table 0.1.

Transfers: Employer contributions - £4.6 billion; Individual contributions - £6 billion; reduction in income related benefits for individuals - £0.4 billion; Government (tax relief) - £ 1.7 billion

Resource costs: Employer administrative costs - £0.2 billion presented in Table 0.2.

Total Cost (PV) **£ 227 billion**

Other **key non-monetised costs** by 'main affected groups' : Compliance and related costs (commercially sensitive); Administration costs to Government as an employer (not estimated)

BENEFITS

ANNUAL BENEFITS	
One-off	**Yrs**
£ 0	1
Average Annual Benefit (excluding one-off)	
£ 12.7 billion	

Description and scale of **key monetised benefits** by 'main affected groups'. The benefits shown here are the average annual benefits between 2012 and 2050 in present (2009/10) prices. These are the annual averages relating to the figures presented in Table 0.1.

Transfers: Individuals' additional saving in private pensions - £12.3 billion per year; Government savings from reduction in income-related benefits - £0.4 billion.

Total Benefit (PV) **£ 224 billion**

Other **key non-monetised benefits** by 'main affected groups'

Benefits to individuals of consumption smoothing (equivalent to around £40-60 billion)

Key Assumptions/Sensitivities/Risks. The success of these reforms is sensitive to the behaviour of individuals and employers. Key assumptions are: individual participation rates, employer choice of qualifying scheme and employer pension contributions following reform. The outcomes for individuals are also dependent on the returns to investment.

Price Base Year 2009/10	Time Period Years 39	**Net Benefit Range** (NPV) **£ 3.8 billion resource cost, £40-60 billion social welfare.**	**NET BENEFIT** (NPV Best estimate) **£ 3.8 billion resource cost, £40-60 billion social welfare benefit.**

What is the geographic coverage of the policy/option?			UK	
On what date will the policy be implemented?			2012	
Which organisation(s) will enforce the policy?			DWP, The Pensions Regulator	
What is the total annual cost of enforcement for these organisations?			£ design dependent	
Does enforcement comply with Hampton principles?			Yes	
Will implementation go beyond minimum EU requirements?			Yes	
What is the value of the proposed offsetting measure per year?			£ 0	
What is the value of changes in greenhouse gas emissions?			£ negligible	
Will the proposal have a significant impact on competition?			No	
Annual cost (£-£) per organisation (excluding one-off)	Micro £100	Small £100	Medium £400	Large £1,900
Are any of these organisations exempt?	No	No	N/A	N/A

Impact on Admin Burdens Baseline (2009/10 Prices) (Increase - Decrease)

Increase of £99 million Decrease £0 **Net Impact** **£99 million**

Evidence Base (for summary sheets)

Income Transfers

The reforms outlined in this Impact Assessment give rise to transfers of income between different economic agents, such as employers, individuals and the Government as well as transfers of income across people's lives. Overall, these transfers favour individuals through increased pension incomes in retirement. Table 0.1 shows these income transfers for specific points in time through to 2050.

Table 0.1: Estimated transfer costs and benefits arising from workplace pension reform measures (£ million)

	Annual average (09/10 prices)	One-off cost (present value)	2012	2020	2030	2040	2050
Individuals							
a) Contribution costs	-6,000	0	*	-5,100	-6,200	-7,600	-9,300
b) Reduction in receipt of income related benefits	-400	0	0	*	-200	-600	-1,300
c) Higher savings into private pension	12,300	0	*	10,500	12,800	15,600	18,900
Net benefit	**5,900**	**0**	*	**5,400**	**6,400**	**7,400**	**8,300**
Employers							
d) Contribution costs	-4, 600	0	*	-3,900	-4,800	-5,800	-7,000
Net benefit	**-4,600**	**0**	*	**-3,900**	**-4,800**	**-5,800**	**-7,000**
Government							
e) Contribution costs (tax relief)	-1,700	0	*	-1,500	-1,800	-2,200	-2,600
f) Reduced income related benefit expenditure	400	0	0	*	200	600	1,300
Net benefit	**-1,300**	**0**	*	**-1,500**	**-1,600**	**-1,600**	**-1,300**

Notes:

- Costs cover the UK.
- All figures are expressed in 2009/10 prices and are rounded to the nearest £100 million.
- Costs are presented as negative numbers, benefits as positive numbers.
- The costs presented here are the sum of employer contributions and tax relief on those contributions. The distribution of these costs will depend on how employers manage costs.
- * means that small costs or benefits arise but are under £50 million. 2012 costs are frequently small because so few individuals are automatically enrolled in 2012 due to the implementation design.

- Higher savings into private pension is the sum of tax relief, Employer contribution and individual contribution costs.

a) Individual Contribution costs: If employees participate in workplace pension schemes and make the minimum contribution of 4 per cent, the value of additional contributions are estimated at £4.5 billion (2009/10 earnings terms) once contributions have been fully phased. This is based on DWP modelling of the current UK pension landscape and assumes that the landscape remains the same but contributions increase in-line with earnings growth over time. This is discussed in Chapter 3.

The £6.0 billion in the summary sheet is the average annual cost of individual contributions from 2012 to 2050, taking into account average earnings growth and discounting for inflation to give 2009/10 prices.

b) Reduction in income-related benefits: Individuals whose income falls below a certain level may be entitled to income-related benefits. For these individuals the Government provides support through Pension Credit, Housing Benefit and Council Tax Benefit to ensure a guaranteed minimum income for those currently aged 60 and over, and to reward those who have been able to make small amounts of private savings. Assuming that the current benefit rules continue to apply, the increase in private pension saving due to these reforms is expected to reduce reliance on income-related benefits in retirement. This is discussed in Chapter 6.[7]

The £0.4 reduction in income-related benefits in the summary sheet is the average annual reduction in income-related benefits from 2012 to 2050, taking into account average earnings growth and discounting for inflation to give 2009/10 prices.

c) Higher savings into pension saving: Capturing the true costs and benefits of automatic enrolment with a minimum employer contribution is difficult as the costs are incurred continuously while the benefits start to accrue when individuals retire. To take account of this, the costs and benefits assume a zero net present value of pension saving in the long-term. This is because the present value of contributions made during a person's working life, including those from their employer and tax relief, is set to equal the gross increase in their private pension savings. Where the rate of return on contributions is the same as the rate at which society discounts future income, pension saving represents a pure income transfer.

Higher private pension savings is the sum of individual and employer contributions plus government tax relief. The £12.3 billion in pension saving benefits in the summary sheet is the average annual benefit in pension saving from 2012 to 2050, taking into account average earnings growth and discounting for inflation to give 2009/10 prices. These estimates are the additional saving that individuals make in to private pensions and not the private pension incomes they will receive as a result of this saving.

d) Employer contribution costs: If employers were to make the minimum employer contribution of 3 per cent for all eligible jobholders who do not opt-out, the value of

[7] This analysis is an illustration of the impact of the reforms on income-related benefits on the current benefits structure. It is not intended to be a projection of any future changes to the benefit system. However, it does take into account planned changes to the State Pension Age.

additional employer contributions would be £3.4 billion[8] once contributions have been fully phased in. This is discussed in Chapter 4. Table 0.1 employer contribution cost estimates show what might happen to employer contribution costs as earnings grow over time. This implicitly assumes that the qualifying earnings band is up rated in line with earnings growth.

The £4.6 billion in the summary sheet is the average annual cost of employer contributions from 2012 to 2050 taking into account average earnings growth and discounting for inflation to give 2009/10 prices.

e) Government contribution costs (tax relief) represent additional annual costs to the Exchequer of tax relief on individuals' pension contributions. The increase in pensions saving by individuals following these reforms will increase the amount of tax relief granted now, but in future will increase the tax paid by individuals on the resulting pension income. Most of the extra tax relief will be given at the basic rate. This is because it is likely that most new savers will be basic rate taxpayers[9], and tax relief on pension contributions is given at the individuals' marginal rate of taxation. This is discussed in more detail in Chapter 6.

In Table 0.1 government contribution cost estimates show what might happen to the costs of government tax relief on individual contributions as earnings grow over time. This implicitly assumes that the qualifying earnings band is up rated with earnings growth.

The £1.7 billion in the summary sheet is the average annual cost of tax relief on individuals pension contributions from 2012 to 2050, taking into account average earnings growth and discounting for inflation to give 2009/10 prices.

f) Reduced income-related benefit expenditure: The reduction in income-related benefit expenditure represents a reduction in costs to Government and is represented as a positive flow. This is discussed in more detail in chapter 6 (Tables 6.29 and 6.30).In Table 0.1 expenditure on income-related benefits increases with in line with earnings.

Resource Costs

In addition to income transfers, there will be resource costs to employers of administering the reforms.

g) Employer administrative costs are based on the latest estimates of the administrative costs to employers of complying with the pension regulations discussed in Chapter 4. These costs are presented slightly differently in three places; the summary sheet, Table 0.2 and Chapter 4.

The £0.3 billion one-off cost presented in the summary sheet is the same as the £300 million one-off cost presented in Table 0.2, and includes those components of the year one costs that arise only in the first year of implementation for all firms. The other figures

[8] These are presented in 2009/10 earnings terms

[9] The 2008 Annual Survey of Hours and Earnings (ASHE) shows that the mean qualifying earnings for members are around £22,300 and for non-members are around £14,800.

in Table 0.2 are the costs of the processes that that will have to be completed on an ongoing basis. The £3.8 billion resource cost in the summary sheet is the total administrative cost over the 39 year period in present value terms.

Table 0.2: Estimated resource costs arising from workplace pension reform (£ million)[10]							
	Annual average (09/10 prices)	One off cost/benefit	2012	2020	2030	2040	2050
g) Employer administrative costs	-200	-200	-300	-100	-200	-200	-300
h) Cost of changing scheme rules	-	-100	0	0	0	0	0
Net Benefit		**-300**	**-300**	**-100**	**-200**	**-200**	**-300**

Notes:

- Costs cover the UK.
- All figures are expressed in 2009/10 prices and are rounded to the nearest £100 million.
- Costs are presented as negative numbers, benefits as positive numbers.
- * indicates that small costs/benefits arise but round to 0.

The administrative burden is a subset of the administrative costs, and only includes those parts of the process which impose an information obligation on business. An information obligation is a regulation that requires a business to provide and submit information to Government or to third parties such as employees and pension schemes. The ongoing annual administrative burden of these regulations is estimated to be £99 million and is discussed more fully in Chapter 4. It has been presented in the summary sheet as an increase in the Admin burden baseline of £99 million.

h) The cost of changing scheme rules relate to the cost of reviewing the rules and making required changes to all open occupational schemes in the run up to the reform. Before an existing occupational scheme can be used for automatic enrolment, the trustees and the sponsoring employer will need to review the current scheme rules to determine whether the qualifying criteria are met. These estimates are discussed more fully in Chapter 4. This has been presented in the summary sheet as part of the one-off transitional cost.

Non-monetised resource costs are costs that have not been quantified and are therefore not included in the summary of costs of and benefits. These include the costs to Government as an employer who will have to automatically enrol eligible employees and the costs of the compliance regime. These costs are discussed in Chapter 6.

[10] These represent the costs to all firms as if they all became subject to the duties at the same time

Resource benefit

Non-monetised resource benefits: The increase in pension saving will be associated with millions of people enjoying increased well-being over their lifetime as a result of transferring income from a period when their income is relatively high (when they are working) to a period in which their income would otherwise be lower (after they retire). This results in a substantial welfare gain to society. We estimate the social welfare gain to be equivalent to around £40 to 60 billion for the period from 2012 to 2050. This amount does not represent a financial transfer but represents the value to individuals from transferring income from more affluent times to retirement.

Table 0.3: Estimated resource benefits arising from workplace pension reforms (£ billion)

	Total cost (present value)	Total benefit (present value)	Net benefit (present value)
Social welfare benefits (units of consumption, in billions)	0	40-60	40-60
Net Benefit	0	40-60	40-60

Notes:
- The social welfare benefits should not be added to the other costs and benefits which are monetary values.
- Costs cover the UK.
- Present values are for the period 2009-2050, and are presented in 2009/10 prices.
- Costs are rounded to the nearest £10 billion.

Figures presented in this evidence base are consistent with the Better Regulation Executive guidelines[11] and are based on our principal scenario of participation in workplace pensions following reform. Costs are in 2009/10 prices terms which means that future price inflation has been taken into account. Present values are discounted to take into account the social discount rate (3.5 per cent falling to 3 per cent after 30 years) as set out in HM Treasury's Green Book.

The analysis covers the full benefits and costs arising from the operation of these reforms up to 2050. In the period prior to 2050 most of this will be seen as costs. However, the benefits from these reforms will continue to accrue for a long time after 2050 as people continue to enjoy a higher pension income in retirement than they otherwise would have had. These benefits continue to increase after 2050, as those who have lived a full working life under these reforms will start to retire in the 2060s. If it becomes possible in the future to carry out this analysis over a longer timeframe, the present value of the costs and benefits presented would be greater. However, the overall conclusion, that this is a balanced package of reforms that will result in a significant increase in future pension incomes and a substantial gain in social welfare, would remain the same.

[11] See: http://bre.berr.gov.uk/regulation/ria/

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base (other results may be annexed).

Type of testing undertaken	*Results in Evidence Base?*	*Results annexed?*
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	No
Sustainable Development	No	No
Carbon Assessment	No	No
Other Environment	No	No
Health Impact Assessment	No	No
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	No
Rural Proofing	No	No

Contents

Chapter 1: Overview and summary of costs and benefits 13
Objectives for reform 13
The need for reform 13
Reform of Workplace Pensions 19
Building Consensus 20
Communicating the reforms 24
Summary of cost and benefits 24
Chapter 2: Impact on the macro-economy and labour market 43
Background 44
Impact on the macro-economy 44
Impact on Social welfare 47
Impact on the labour market 47
Economic Downturn 49
Chapter 3 Impact on Individuals 51
Background 51
Impact of pension regulations on individuals 52
Short-term impact on individual saving 61
Postponement periods 61
Protecting individual savings 62
Chapter 4: Impact on Employers 63
Background 63
Current pension provision by employers 63
Employer attitudes to reform 65
Costs to Employers of Pension Regulations 66
Regulations to minimise burdens on employers 76
Chapter 5: Impact on Pension Industry 81
Background 81
Current Pensions Landscape 82
Impact of reform on demand for pension provision 85
Impact of reform on the supply of pension provision 85
Chapter 6: Impact on Government 91
Background 91
Direct costs of implementing the workplace pension reforms 91
Costs of tax relief 93
Impact on expenditure on Tax Credits and Income-Related Benefits 95
Costs to Government as an employer 96
Annex A: Impact on small firms 97
Annex B: Competition assessment 105
Annex C: Gender impact assessment 112
Annex D: Race impact assessment 115
Annex E: Disability impact assessment 117
Annex F: People benefiting from private pension reform - explanation of participation estimates 119
Annex G: Estimates of the employer administrative costs of reform 126

Methodology **127**
Annex H: Social Welfare Estimates: explanation of the methodology and assumptions 136
Annex I: Estimates of costs and benefits - assumptions and methodology 139
Annex J: Glossary 142

Chapter 1: Overview and summary of costs and benefits

Objectives for reform

1.1 The Pensions Act 2008 and Workplace Pension Reform Regulations 2010[12] aim to increase private pension saving in the UK. They form part of a wider reform package designed to ensure the UK has a pension system fit for the twenty first century and provides dignity and security for tomorrow's pensioners.

1.2 The policies in the Pensions Act 2008 meet the five tests for pension reform that the Government set out in the May 2006 White Paper *Security in Retirement: towards a new pensions system.* The five tests are that the reforms: support personal responsibility and deliver fairness, simplicity, affordability and sustainability.

1.3 The Workplace Pension Reform regulations are guided by three key principles:

- **Protection for individuals**: ensuring that workers can access pension saving to which they are entitled;
- **Fairness to employers**: implementing the reforms in a way that minimises additional costs for employers, particularly those who are doing everything required of them; and
- **Support for existing pension provision**: ensuring the reforms strengthen the pensions market and build on good pension provision that is already in place.

The need for reform

1.4 In 2002 the Government established an independent Pensions Commission to consider the long-term challenges facing the UK pension system and whether the existing voluntary pension saving regime represented an adequate response. The Commission concluded that while there was no immediate 'pensions crisis', the existing system would have to be reformed to ensure it would meet several long-term challenges[13]:

- **Demographic and social change:** the proportion of the population aged 65 or over is rising rapidly because of increasing life expectancy and lower fertility rates. This

[12] Workplace Pensions Regulations are a package of regulations which includes: the Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010, the Employers' Duties (Implementation) Regulations 2010 and the Employers' Duties (Registration and Compliance) Regulations 2010.

[13] The Pensions Commission, 2004, *Pensions: Challenges and Choices: The First Report of the Pensions Commission* and 2005, *A New Pension Settlement for the Twenty First Century: The Second Report of the Pensions Commission.* Available at: http://www.webarchive.org.uk/wayback/archive/20070801230000/http://www.pensionscommission.org.uk/index.html>

means there is an increased cost on those who are working to maintain the pensions of the economically dependent.[14]

- **Under-saving for retirement:** millions of people are not saving enough to deliver the income they are likely to want or expect in retirement;
- **Inequalities in the state pension system:** the state pension system was rooted in the society of the 1940s and no longer reflected the way people live their lives today, especially as it failed to fully recognise the contributions of women and carers; and
- **Complexity**: the complexity of the state pension system stopped people from making informed decisions about whether, when and how much to save.

1.5 The Pensions Act 2007 enabled the introduction of a simpler, fairer and more generous State Pension system, funded by a gradual increase in the State Pension Age. Implementation of these changes from April 2010 will provide a firmer foundation upon which people can build savings for their retirement.

1.6 On its own, however, the State Pension system will not provide the retirement income that many people want. The Pensions Commission used the concept of a replacement rate to measure adequate retirement income. The Commission concluded that a person on median earnings[15] should be aiming for at least a 45 per cent replacement rate - that is, to retire on 45 per cent of what they earned during their working life.[16]

1.7 As a result of the 2007 Act, a median earner retiring in 2055 can expect to retire on 32 per cent of what they earned during their working life from the state.[17] Therefore, relying on state provision alone will provide retirement income that falls short of many people's expectations. If the Government increased the generosity of the basic State Pension so that a median earner received a benchmark rate of 45 per cent, the cost would be prohibitive. This cost was estimated to be around £80 billion per annum at the time of the Bill Impact Assessment.[18]

---

[14] According to the ONS, the old age dependency ratio – the number of people of pensionable age as a percentage of the working age population – has been steady at around 30 per cent since the mid-1970s, but is forecast to rise from 2006. In the absence of any increases in state pension age, the old age dependency ratio would have been expected to reach 49 per cent by 2051. With the increases in State Pension Age taking place between 2010 and 2046, it is expected to be 34 per cent in 2051. Information available at: http://www.statistics.gov.uk/downloads/theme_compendia/pensiontrends/Pension_Trends_ch02.pdf

[15] Median earnings are at the mid-point of the range of earnings in the UK. In 2009/10 according to the Annual Survey of Hours and Earnings, median earnings were approximately £20,300.

[16] The Pensions Commission looked at several ways of considering what an 'adequate' pension in retirement was, including: international comparisons and time trends of pensioner income, analysis of lifetime consumption patterns, observed pattern of replacement rates at retirement and survey evidence of people's preferences. Considering the evidence, they concluded there was no clear definition of pension 'adequacy'. The Pensions Commission proposed a replacement rate of about 45% for the median earner. A target at this level they felt significantly reduces the risk of severe under-saving (if combined with policies to facilitate additional, purely voluntary saving on top) but minimises the danger that the state will encourage people to save inappropriately, since the vast majority of people (even those with housing or other non-pension assets) are likely to desire a pension of at least this level. .

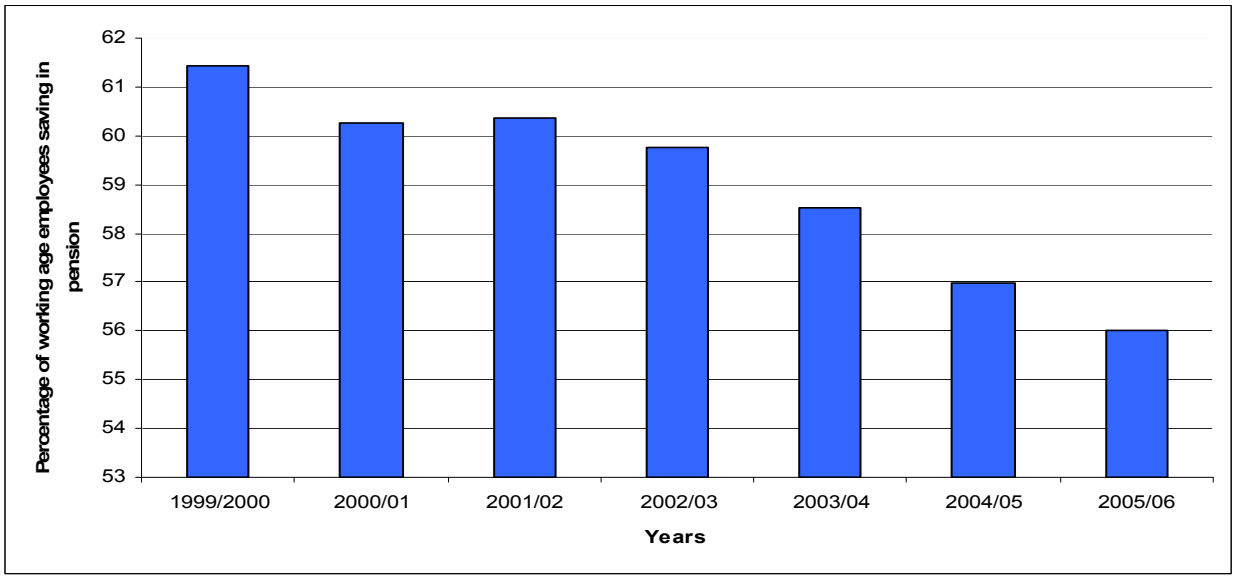
[17] This estimate is based on DWP modelling

[18] DWP, 2008, *Pensions Bill- Impact Assessment,* Available at: http://www.dwp.gov.uk/docs/impact-assessment-240408.pdf

1.8 The gap between State Pension income and the income that individuals want in retirement may be filled in different ways. Many people will want to work for longer and the Government wants to encourage and help those who choose to do so[19]. Some people may have substantial housing assets or non-pension savings. However, the Pensions Commission concluded that for most people, this would not deliver adequate retirement income and people would need to save more in private pensions.

1.9 Yet levels of private pension saving are low and falling. In 2005/06, 44 per cent of working-age employees and 51 per cent of those earning between £5,000 and £25,000 were not saving in a pension. Trends in employer provision suggest levels have continued to fall beyond 2005/06.

Figure 1.1: Percentage of working-age employees in Great Britain contributing to a private pension[20]



Source: Family Resources Survey
Note: Working-age employee is defined as individuals in employment who are aged 20 to State Pension age.

1.10 The Department for Work and Pensions estimates that about 7 million people are not saving enough for retirement.[21] People on moderate to low incomes are more

[19] HM Government, July 2009, *Building a society for all ages* sets out how the Government is helping older people engage with work and the economy, for example by bringing forward the review of the Default Retirement Age – which means employers may require employees to retire at 65 – to 2010 from 2011

[20] *Family Resources Survey 2005/06*. Working-age employee is defined as individuals in employment who are aged 20 to State Pension age. Questions on pension provision were changed for the 2006/07 FRS to try to provide more information on the type of private pension scheme, but problems were identified during analysis as some respondents reported dormant (closed) pension schemes memberships as if they were live memberships. It has not been possible to identify and exclude all the dormant memberships on a consistent basis. As a result, FRS data for 2006/07 to 2008/09 over-state pension participation rates compared to other sources, and DWP has taken the decision not to publish tables and indicators showing pension participation rates for these years. Estimates will be updated with the 2009/10 survey when the data becomes available.

[21] This figure is based on DWP modelling using data from the English Longitudinal Study of Ageing (ELSA) and was published in the May 2006 White Paper, *Security in retirement: towards a new pension system.* There are two main reasons for differences between the DWP and Pensions Commission figures:

likely than other workers to be not saving enough for their retirement. There are four main reasons for this:

- **Poor understanding:** Research shows that most people have low financial literacy and tend to exhibit poor understanding of pensions and the benefits of saving for retirement. Only 5 per cent of people say they have a 'good' knowledge of pensions while two-thirds claim their knowledge is 'very patchy' or they know 'little or nothing'.[22] This lack of understanding is made worse by 'myopic' behaviour - a tendency to live for today rather than save for the future. The latest Wealth and Assets Survey finds that around two-fifths (39 per cent) of individuals choose to live for today rather than save for tomorrow.[23]
- **Inertia:** Even if people understand the need to save, they suffer from 'inertia' and do not get around to making the decision because current spending pressures seem more important than the future. Research shows that many people have access to a workplace pension but fail to join, even where it seems to be in their interest and they are given information about the value of doing so.[24]
- **Declining employer provision:** Employer provision of workplace pensions is becoming less generous. There is a shift away from defined benefit schemes, which generally have higher employer contribution rates, towards defined contribution schemes. There is also a shift away from trust-based schemes to contract-based schemes, like stakeholder pensions which are seen as less costly and burdensome for the employer to provide.[25]
- **Lack of suitable provision:** Although significant elements of the pension market work very well, there is a lack of suitable pension products for people on low to moderate incomes, or those working for small firms. Due to weak demand for pensions, providers incur higher costs in convincing these groups that they need to save in a pension. The complexity of pension products means that individuals find it difficult to make well-informed choices. This leaves them in a vulnerable position. Both of these issues make the process of selling a pension more expensive for providers. This problem is exacerbated when employers are small because providers are unable to spread their costs over a larger number of employees. The Pensions Commission estimated that the cost of setting up a pension scheme will generally exceed the returns to providers when dealing with firms of 20 employees or fewer.[26]

---

the DWP estimate is based on household level data, while the Pensions Commission's figures are based on individual level data (this means that an individual with a low pension themselves but whose spouse has enough for both would be counted by the Pensions Commission as an under-saver but not in the DWP's estimates; the Pensions Commission looked just at pension wealth, while the DWP estimates include other financial assets, non-owner occupied housing wealth and business assets.

[22] Clery, E, McKay, S, Phillips, M and Robinson, C, 2007, *Attitudes to pensions: the 2006 survey*. DWP Research Report 434. See also Wicks, R, and Horack, S, 2009, *Incentives to save for retirement: Understanding perceptions and behaviour*: *A literature review.* DWP Research Report No 562.

[23] *Wealth and Asset Survey 2009 (Great Britain Wave 1),* Available at: http://www.statistics.gov.uk/downloads/theme_economy/wealth-assets-2006-2008/Wealth_in_GB_2006_2008.pdf

[24] Clery, E, McKay S, Phillips M and Robinson C, 2007, *Attitudes to pensions: the 2006 survey*, DWP Research Report 434.

[25] Dobson, C and Horsefield, S, 2009, *Defined Contribution pension provision,* DWP Research Report 608.

[26] The Pensions Commission, 2004, *Pensions: Challenges and Choices: The First Report of the Pensions Commission* and 2005, *A New Pension Settlement for the Twenty First Century: The Second Report of the Pensions Commission*.

Box 1.1 Behavioural barriers to saving for retirement

Inertia. This is a key factor that has been explored by economists such as Richard Thaler, which explains why saving for retirement can be a decision that is very likely to be put off until tomorrow as it relates to something far in the future. The way that options are presented to individuals and the effort required in taking action can have significant impacts on behaviour.

Myopia. In contrast to economic theory, individuals are often observed spreading their financial resources over only relatively short timeframes, particularly at younger ages. Without triggers to encourage thinking about retirement and with pressing financial and other constraints, many people may focus on meeting working-age financial needs without considering their retirement saving. Linked to this is '**hyperbolic discounting'** where individuals do not discount the future at a constant rate, so that their preferences for future consumption are not consistently related to preferences for current consumption. This can lead to expectations for future needs not being met – people may prefer to consume more now but when they get to later life they may become unhappy with their previous decisions.

Bounded rationality. Pension decisions may be too complex for individuals to solve on their own, particularly as some individuals may have low financial capability. Thus, they can make decisions that may not be fully optimal. To reduce the effort (and therefore cost) of making complex decisions, individuals use 'rules of thumb' to help choose when and how to save (e.g. £x per month, regardless of income/interest rate, etc).

Habits. Individuals are habitual which can help explain why people do not react to changed financial incentives, even if it would be rational and financially beneficial for them to alter their behaviour. For example, once in the habit of saving it is a lot easier to keep going, whilst inertia may kick in if saving is not yet habitual.

Other drivers of savings behaviour include: **Loss aversion** when Individuals are also often strongly averse to losing money and may often accept lower positive returns in order to avoid negative ones, even if they may be risk takers when it comes to situations where there are no loss possibilities; and **Herd mentality** when individual decisions are often made by observing and copying others, particularly if this reduces the effort required to carry out a full rational analysis of all the available options. Social norms are important indicators of behaviour. If the majority of someone's peers own a house, have an Individual Savings Account (ISA) and contribute to a pension, they may be more likely to consider taking these actions as well.

Individuals may also follow norms of 'mental accounting' to help conceptualise their financial obligations, for example, having different savings accounts for various purposes. This means that it is less easy to predict how current consumption will respond to gains in income as the result is dependent on which account the individual allocates the gain to. For example, a gain of £1,000 in the value of housing wealth may be allocated to a different mental account from an equivalent gain from a work bonus.

Source: DWP (2009) *Saving for retirement: Implications of pension reforms on financial incentives to*

save for retirement. Research Report No 558

1.11 The nature of demand in the pensions market also works against improving services and reducing costs. This is because of the specific nature of pension products and is discussed in more detail in Chapter 5.

Reform of Workplace Pensions

1.12 The Pensions Commission concluded that without Government intervention, private pension membership and contributions will, at best, remain level as life expectancy increases, and may well continue to fall. In its 2005 report[27], the Pensions Commission made two key recommendations to overcome these barriers to private pension saving, which were accepted by the Government:

- A system of automatic enrolment[28] into workplace pensions, with employers required to make a minimum contribution to their workers' pension funds; and
- A new pension scheme, designed to provide a simple and low-cost way of saving for low to moderate income earners.

1.13 In 2006, the Government published two White Papers[29] setting out the framework for automatic enrolment and the proposed new pension scheme (referred to as the personal accounts scheme in this document.)[30]

1.14 The Pensions Act 2008 sets out in legislation the key elements of the reforms, including:

- Who needs to be automatically enrolled and who is eligible for an employer contribution into their pension;
- Broadly, what pension schemes will need to look like to be used by employers to meet their obligations;
- What the Pensions Regulator (TPR) can do if employers do not meet their obligations, for example issue warning notices and penalties; and
- The role of the Personal Accounts Delivery Authority (PADA) in setting up the personal accounts scheme.

1.15 The Pensions Act 2008 gives the Secretary of State the power to make regulations to require employers to automatically enrol eligible jobholders into qualifying workplace pension saving. Draft regulations have been developed and formally consulted on in 2009. A set of regulations underpinning the Pensions Act

---

[27] The Pensions Commission, 2005, *A New Pension Settlement for the Twenty-First Century: The Second Report of the Pensions Commission*.

[28] Under the Pensions Act 2008 there is a duty on employers to automatically enrol their jobholders aged above 22 and earning £5, 035 (in 2006/7 earning terms) or more into a qualifying workplace pension scheme.

[29] DWP, May 2006, *Security in retirement: towards a new pension,* Available at: http://www.dwp.gov.uk/policy/pensions-reform/security-in-retirement/white-paper/ and DWP, December 2006, *Personal accounts: a new way to save* Available at: http://www.dwp.gov.uk/policy/pensions-reform/personal-accounts/

[30] The name for this new pension scheme has been announced in January 2010. In this impact assessment, however, it is referred to as the personal accounts scheme.

2008 are being laid in Parliament in January 2010. This Impact Assessment accompanies this set of pension regulations.

1.16 The Impact Assessment builds on the analysis presented in the Impact Assessments that accompanied the Pensions Bill 2008 and draft regulations consultations in 2009. It presents the overall impact of the reforms on employers, individuals, the pension industry, the economy and the Government. The estimates presented in this Impact Assessment may be different from those presented in earlier Impact Assessments to reflect the latest evidence and research where available.

Building Consensus

1.17 To plan and save for their futures, people need to be confident that the decisions they make today will not be undermined by frequent changes to the pensions system. The Government has therefore worked hard to build a broad-based consensus amongst political parties, the public, businesses and the pensions industry to ensure these reforms can stand the test of time.

1.18 In **March 2009** we consulted on regulations covering the automatic enrolment process.[31] In **April 2009** we consulted on the draft scheme order and rules for the personal accounts scheme.[32] In **September 2009**, we consulted on remaining regulations to implement and enforce the reforms[33].

1.19 As a result of the March 2009 consultation on the automatic enrolment process, significant changes were made to the draft regulations including extending the joining window from 14 days to 1 month; simplifying timescales and information requirements; giving further consideration to the burden and cost of refunds by recommending an amendment to the 19 day rule[34] and giving further consideration to how postponement[35] relates to short-term workers. Details of these changes are discussed in the relevant Government Response.[36]

1.20 No significant changes were made to the draft order and rules for the personal accounts scheme as respondents to the April 2009 consultation broadly agreed with the proposals. Further provision has been made to enable the Secretary of State to place limits on the charge level for the personal accounts scheme if it is inconsistent with the intentions of Parliament in establishing the legal framework for the scheme, while ensuring the Trustee Corporation has day-to-day responsibility for the

---

[31] DWP, 12th March 2009, *Pensions- Consultation on Draft Regulations*, Available at: http://www.dwp.gov.uk/docs/pensions-auto-enrol-regs2009.pdf

[32] PADA/DWP, 28th April, 2009, Pensions- Consultation on draft Scheme Order and Rules Available at: http://www.dwp.gov.uk/docs/draft-scheme-order-and-rules28april2009.pdf

[33] DWP,24th September, 2009, Pensions- Consultation on Draft Regulations, Available at: http://www.dwp.gov.uk/docs/workplace-pension-reform-completing-the-picture-consultation240909.pdf

[34] See Annex 1 for an explanation of the 19th day rule and its impact on employers, individuals and the pension industry.

[35] See Annex 1 for an explanation of postponement periods and its impact on employers, individuals and pension industry.

[36] DWP, September 2009, *The Pensions (Automatic Enrolment) Regulations 2009: Government Response to the Regulations,* Available at: http://www.dwp.gov.uk/docs/pae-regulations-2009-govt-response-sept09.pdf

scheme's charge level. A few minor changes were made to the wording of some articles to increase clarity and understanding.[37]

1.21 A number of changes have been made to the remaining workplace pension reform regulations following the formal consultation in September 2009. The two main changes are that certification has been removed from this batch of regulations, and the regulations on postponement have been amended to allow postponement for all workers, but to prevent repeated postponement of the same worker by an employer in any 12 month period. A number of modest changes have also been made to other policy areas to meet stakeholder concerns.

1.22 Changes have also been made the implementation of the reforms. We have continued to assess the implementation plan in the context of the current economic circumstances. Our priority is to get the infrastructure in place as quickly as possible, whilst ensuring the reforms are delivered in an operationally achievable way that also supports the economy as it recovers from the current economic downturn. This is best achieved by supporting employers and individuals to adapt to the reforms in a way that maximises sustainability and ensures the maximum shift in savings culture over the medium to long term. After careful consideration we have decided to adjust the implementation plan to help new companies, which are essential to economic recovery and growth. We will allow new firms setting up during implementation more breathing space to establish themselves before coming under the employer duties. New companies and some of the smallest existing firms will be brought into the duties after the main staging for existing employers is complete.

1.23 This extra support for business means, in turn, that some employees in existing firms will be automatically enrolled into a workplace pension later in 2016. As the implementation period has been adjusted, the minimum level of contributions for individuals will increase in the following increments - to three per cent in October 2016 and to five per cent in October 2017. Minimum contributions for employers will increase from one per cent to two per cent to three per cent to the same timetable. . Full details of all the changes between the draft Pensions (Workplace Pension Reform – Completing the Picture) Regulations consulted on and the final version of these regulations are discussed in the relevant Government Response.[38]

1.24 In addition to the formal consultation, Ministers and officials at the Department for Work and Pensions (DWP) have regularly met with representatives of the pensions industry, employers and consumer groups to explain and consult on these proposals. During the consultation period, DWP arranged three seminars with employers of all sizes, employee benefit companies, consumer representative organisations and intermediaries to discuss the regulations. At the same time, DWP commissioned qualitative research with small and medium sized employers on the impact of draft regulations on their businesses.[39]

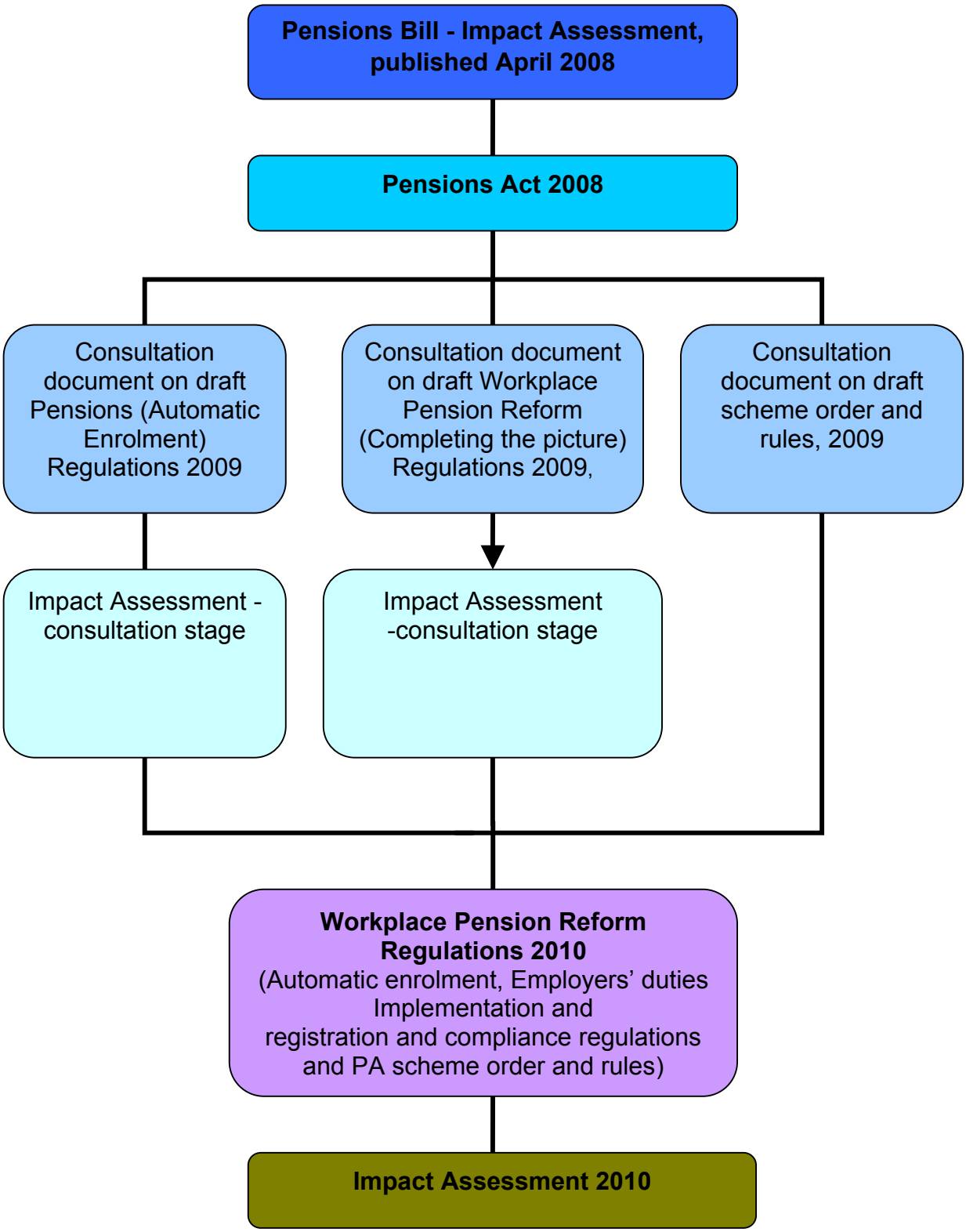
---

[37] DWP, October 2009, *Pensions – Summary of responses to the consultation on the draft scheme order and rules.* Available at: http://www.dwp.gov.uk/policy/pensions-reform/

[38] DWP,12th January 2009, *The Pensions (Completing the Picture) Regulations 2009: Government Response to the Regulations,* Available at: http://www.dwp.gov.uk/policy/pensions-reform/

[39] Wood, A, Robertson, M and Wintersgill, D, 2010, *Pension reforms Batch 2 consultation: Qualitative research with small and medium sized companies*, Available at: http://www.dwp.gov.uk/policy/pensions-reform/

1.25 **Figure 1.2: Sequence and coverage of workplace pension reform regulations**



Summary of Pension Regulations

1.26 The Pensions Regulations, which this Impact Assessment supports, set out the requirements for pension reform from 2012. The regulations are discussed in detail in Box 1.2.

Box 1.2. What is prescribed in pension regulations?

a) **The Occupational and Personal Pension Scheme (Automatic Enrolment) regulations 2010** prescribe arrangements which the employer must follow to comply with the employer duties on automatic enrolment. This includes details on:

- The information that employers need to provide individuals and pension schemes about the enrolment process.
- How contributions are to be deducted and the pay reference periods the deductions need to be based on.
- When individuals can opt-out of pension saving and what employers and pension schemes need to do during the opt-out and refund processes.
- When employers can postpone automatically enroling jobholders into workplace pensions.
- Employer duties towards voluntary savers.
- The processes of re-enroling jobholders into pension savings and employer duties when they choose to move jobholders from one qualifying scheme to another.
- The quality requirements of UK based and non-UK based qualifying schemes.

b) **The Employers' Duties (Implementation) 2010 regulations**, discuss how and when the reforms will be implemented. Under the regulations, employers will start complying with their duties at different points in time (staging). And the minimum contribution employers and individuals are required to make into workplace pensions will be phased in over time (phasing).

c) **The Employers' Duties (Registration and Compliance) 2010 regulations** give details of the compliance regime. This includes:

- The processes of registration and record keeping that employers and pension schemes will need to comply with under the reforms.
- Detail of the enforcement powers available to the Pensions Regulator when an employer fails to comply with their requirements (e.g. not automatically enrolling eligible jobholders into pension saving, inducing workers into opting-out of pension saving or not paying the right amount of contributions when due).

d) **The personal accounts scheme order 2010** set out the terms of the personal accounts scheme which is designed to provide a simple and low-cost way of saving for low to moderate income earners who do not have access to pension provision. This includes key aspects of the scheme which fulfil the policy objective - including the public service obligation to accept any employer who wishes to use the scheme to fulfil their new duty.[40]

Communicating the reforms

1.27 Communication and information will be vital to support the successful implementation of the reforms.

1.28 DWP is working closely with both the Pensions Regulator and the Personal Accounts Delivery Authority to develop coordinated communications to meet the needs of the different target audiences.

1.29 DWP will deliver communications and information to individuals and support engagement with employers and their intermediaries by raising awareness of the pension reform and the role employers will play. The intention is to start raising awareness of the reforms in 2010.

1.30 TPR will be responsible for providing information about how employers can comply with their new duties. TPR plans to have guidance available from summer 2010. This guidance will be supported by an engagement campaign with key stakeholders through 2010. In the autumn of 2010, TPR is planning to engage directly with intermediary bodies and large employers to raise awareness and identify what they need to do in preparation for the reforms. TPR's communication and education campaign is being designed to help employers and the intermediaries understand what must be done to meet the new employer duties. There will be guidance available as appropriate, for employers to use.

1.31 PADA (and then, when established, the Trustee Corporation) will provide information about the personal accounts scheme to its prospective employer customers and their advisers. This will build during 2010 and 2011 in the lead-up to automatic enrolment. The Trustee Corporation, responsible for running the personal accounts scheme, is expected to be in place during this year and will communicate with members as they join the scheme.

Summary of cost and benefits

1.32 This impact assessment presents the impact of the reforms on employers, individuals and the pensions industry as well as broader impacts on the economy, government finances and the labour market. The impact of specific regulations on employers, individuals and the pension industry is discussed in Appendix 1. The overall impacts on the economy, individuals, employers, pension industry and the Government are discussed in Chapters 2, 3, 4, 5 and 6 and summarised below.

Impact of the reforms on the economy and the labour market

1.33 Chapter 2 looks at the impact of the reforms on the economy and the labour market. It covers **four areas**:

Increase in overall savings and the effect on the economy:

- DWP's principal estimate is that a policy of automatic enrolment and mandatory contributions from individuals and employers will generate pension savings of up to approximately £9 billion per year by 2020.[41] Of these, an estimated 50 to 70 per cent

are expected to represent additional household saving.[42] This is equivalent to less than half of one per cent of Gross Domestic Product.

- Increased pension saving has a small positive effect on the economy. In 2006, DWP commissioned the National Institute of Economic and Social Research (NIESR) to simulate the effect of this increase in savings on the macro-economy. Their modelling assumes that in the short-term, higher savings will result in lower consumption as people will have less disposable income. This has a small downward effect on economic growth in the first few years. In 2015, the effect of lower consumption is a reduction in output by less than 0.15 per cent, which is the cumulative effect of annual impacts so small that they are unlikely to be detectable (below 0.05 per cent). In the long-run, in the NIESR modelling, the extra savings from the reforms result in rises in income (as measured by Gross National Product) by 0.2 per cent as a result of extra investment income received from abroad.[43]

Increases in Social Welfare as individuals spread their income over their lifetimes

- The reforms will enable people to transfer income from their working life to increase their income in retirement. Individuals will invest in a pension at a time when they have relatively more income in order to set money aside for when they have less income (retirement). This is known as consumption smoothing. As a result, the expectation is for society as a whole to feel substantially better off.[44] According to the methodology set out in a DWP technical working paper[45] which has been updated to account for the uncertainty surrounding some of the assumptions, the impact of consumption smoothing will be to increase social welfare by around £40 to 60 billion for the period up to 2050. This amount does not represent a financial transfer but represents the value to individuals from transferring income from more affluent times to retirement.[46] The methodology behind these estimates is discussed in detail in Annex H.

Impact on employment depending on how employers cope with increases in non-wage costs

- It is difficult to know the exact effect the reforms will have on employment without knowing how employers respond to the reforms at the time when reforms are implemented. However, the potential labour market impact of the reforms can be estimated based on reasonable assumptions using:

- ***Elasticity of labour demand to changes in non-wage labour cost:*** While this estimate is likely to vary across different types of employers, a reasonable assumption is an elasticity of -0.5.[47] This implies that a 1 per cent increase in labour costs will result in 0.5 per cent fall in employment. Using this estimate of the elasticity of labour demand to increases in non-wage labour costs suggests that in the long-run workplace pension reforms can reduce employment by around 70,000.[48]
- ***Findings from employer attitude surveys:*** on what they are most likely to do in response to the reforms. Using this, the employment impact of the workplace pension reforms on employment is estimated to be between 10,000 and 80,000 or a reduction of between 0.1 to 0.4 per cent in private and not-for-profit employment. [49]

The lower estimate is based on employer responses in which 8 per cent of employers said they could restructure or reduce employment. The higher estimate is based on the responses of a very small proportion of employers who reported that their most likely response would be to close their firms.

Interaction between the reforms and the economic downturn of 2008 and 2009

- The financial recession of 2008 and 2009 may well have had an adverse impact on public confidence in financial products and the willingness of employers and employees to participate in these reforms. Against this context, DWP commissioned the National Institute of Economic and Social Research to assess if recent economic developments had made any difference to the appropriateness of the policy goal of increasing private retirement saving, particularly through the workplace pension reforms. The reports conclude that the current recession does not have any substantial impact on the rationale for the introduction of workplace pension reform.
- At present, according to independent forecasts collated by HM Treasury in November 2009, on average, experts are expecting Gross Domestic Product growth of 2.3 per cent in 2012 and 2.7 per cent in 2013.[50] This means that the economy is set to recover before the reforms are introduced.

Impact on Individuals

1.35 Chapter 3 discusses the impact of workplace pension reform on individuals. Annex C, D and E discuss the impact of the reforms on individuals in terms of gender, race and disability. Together, they cover **three key areas**:

The impact of the reforms on individuals

- ***Number of new savers***: Automatic enrolment is one of the most effective joining techniques to overcome people's tendency not to act when faced with difficult financial decisions. As a result of these reforms, our latest working assumptions suggest that around 10 to 11 million people (4 to 5 million women, see Annex C for gender impacts) will be eligible for automatic enrolment into a workplace pension. After accounting for people who opt-out, we expect this will result in 5 to 9 million people (2 to 3 million women) newly saving or saving more in all forms of workplace pensions. Annex F contains a detailed explanation of the participation estimates presented in this impact assessment.

- Inertia and lack of confidence in making financial decisions appear to be more significant barriers for women than men in saving in a pension scheme. Research on the 401(k) experience in the United States shows that amongst employers that chose to use automatic enrolment it had the greatest effect among people on low incomes, people from minority ethnic groups and women.[51]

- Employees who are disabled are just as likely as non-disabled employees to participate in private pension saving (59 per cent of disabled employees contributing to a private pension, compared with 57 per cent of employees who are not disabled).

These figures reflect the fact that disabled people are slightly more likely to work in the public sector where workplace pension membership is higher.[52]

- Individuals can choose to opt-out of pension saving. Individuals will choose to opt-out if they do not consider it the right time for them to save in a workplace pension. This can be due a range of reasons for instance that individuals are already making sufficient provision for their retirement, or have other priorities, such as reducing debt.[53] For those individuals that choose not to save because it does not suit their personal circumstances, the opt-out process is designed to support the individual's decision not to save.[54]

- Changes in income, employment and domestic arrangements may drive some individuals who have opted out to want to save at a later point.[55] Re-enrolment will help maximise savings and harness decision-making inertia by providing individuals with an opportunity to reconsider their savings decision. The number of individuals who are re-enrolled is likely decline as reforms to workplace pension savings become embedded over time.

- ***Amount of pension saving and impact on retirement incomes***: For individuals participating in workplace pension schemes and making the minimum contribution of 4 per cent, the aggregated annual pension contributions are estimated at £4.5 billion (2009/10 earnings terms) once contributions have been fully phased in. This is within a range of £3.2 billion to £5.1 billion.

- Table 1.1 shows aggregate annual pension contributions from individuals participating in workplace pension schemes between 2020 and 2050.This is based on DWP modelling of the current UK pension landscape and assumes that contributions increase inline with earnings growth over time.

Table 1.1: Estimated total individual contributions in future years (£ billion)

	2020	2030	2040	2050
Individual contributions	**5.1**	**6.2**	**7.6**	**9.3**

Source: DWP modelling.
Note: Costs are expressed in 2009/10 prices and are rounded to the nearest £100 million

- The main aim of pension saving is to ***smooth one's income between work and retirement***. Automatic enrolment and minimum employer contributions enable individuals to transfer income from their working life to increase their income in retirement. As a result, many individuals are likely to enjoy increased well-being over their lifetime through an economic concept known as 'consumption smoothing'.

- ***Private pension incomes*** will increase. By 2050, increases in private pension incomes are estimated at around £11 to 14 billion a year (in 2009/10 prices), or £5 to 7 billion in 2009/10 earnings terms. The reforms could increase private pension income for pensioners aged between 68 and 75 in 2050 by over ten per cent. The projections are based on modelling the impact of the pension reform on future retirement incomes using the DWP's Pensim2 model.[56]

- ***Impact on retirement income*:** most individuals, at the point of automatic enrolment, can expect to get back more in real terms than they put in. Analysis by the DWP shows that for the vast majority (over 95 per cent) of individuals, the improvement in their retirement incomes is greater than the cost of contributions. Most get back more than twice the amount they put in, after taking inflation into account.[57]

- These reforms will offer an opportunity for women to build up private pension savings in their own right and help to substantially increase their final pension entitlement at retirement. This is true for those who expect to work or care for most of their working life, irrespective of their income level.

Specific short-term impacts

- The objective of the reforms is to maximise individual saving while minimising burdens on employers and impacts on the pension industry. Certain regulations designed to improve the operational viability of the reforms or minimise burdens on employers can potentially reduce contributions to pension saving in the short-term. This will affect retirement incomes that individuals will enjoy in the long-term.

- ***Implementation regulations:*** Any staged approach to automatic enrolment and default contributions, when compared with a scenario where default contributions are immediate and in full, will have a slightly adverse effect on pension savings built up by savers that are automatically enrolled towards the end of the implementation period. For instance in a scenario were individuals are automatically enrolled in September 2016 they could have a pension fund 3 per cent lower than if the same individuals had been automatically enrolled in the first stage and became subject to the duties in October 2012.[58]

- The adverse effect on pension saving may be proportionately greater for some individuals, for example older workers at the point of automatic enrolment and those with career breaks who will have less time to build up their savings under the reforms. This is because the contributions foregone represent a larger proportion of their potential savings. This means that the gradual implementation will have a slightly more adverse effect on women and ethnic minority groups as they are more likely to take career breaks or work for smaller firms and be staged in later. [59]

- Overall, employees who are disabled are equally represented across all firms and do not have broken work histories.[60] The implementation design will therefore have a similar impact on disabled people in employment as those who are not disabled.

- ***Active membership***: The regulations allow employers a one month gap between active membership in qualifying schemes when they are replacing one qualifying scheme with another. In an extreme scenario, a monthly gap in a jobholder's contributions eight times over their working life could lead to a reduction in total fund size of 2 per cent, compared to an individual who experiences continuous contributions throughout their working life.[61]

- ***Postponement***: An employer may postpone the automatic enrolment of a given employee into a pension scheme for up to three months provided they subsequently automatically enrol their employee into a workplace pension scheme which requires an employer contribution of at least 6 per cent of qualifying earnings. The higher level of contribution must continue for a minimum of three months following the

postponement period. Employees in sectors with high turnover rates are the most likely to be affected by postponement periods. However, employers taking on staff on consecutive short-term contracts can not use postponement if the jobholder's automatic enrolment date has already been postponed at any time during the previous 12 months.

Regulations designed to protect individual savings

- The Government's reforms to the private pension system will introduce important new rights for workers and requirements for employers. The Pensions Regulator will be responsible for building and operating an effective Employer Compliance Regime. Individuals who report an employer's breaches to TPR will be protected against being treated unfairly as a result.

Impact on Employers

1.36 Chapter 4 discusses the impact of workplace pension reforms on employers. Annex A focuses on the impact of the reforms on small firms. Together they cover **four key areas**:

Current pension provision by employers

- Overall workplace pensions have increased when 2001 legislation came into place requiring employers with five or more employees to provide employees with access to a Stakeholder Pension (SHP). But employees often do not participate in workplace pension schemes and even where they do the scheme does not always attract an employer contribution, especially in smaller firms. Analysis by DWP shows that of the 1.3 million employers in the private and not-for-profit sectors approximately 270,000 employers offered a contribution greater than 3 per cent. [62]Provision tends to be better amongst large employers.

Employer attitudes to workplace pension reform

- The majority of employers support the reforms. In 2009, 56 per cent of employers believed that these reforms were a good idea, although views are affected by current economic conditions.

The costs to employers of workplace pension reform.

- The pension regulations have been designed to encourage the maintenance and expansion of existing good workplace pension provision. The reform will, however, require 750,000 firms to provide a workplace pension for the first time and other firms to expand existing provision to all of their eligible jobholders and/or improve existing provision so that the quality requirements are met. The regulations will lead to increased contribution and administrative costs to employers. The magnitude of these costs in relation to each employer will depend on the nature of their existing pension provision, current participation levels and how they choose to comply with the duties.

- **Impact on employer contributions costs:** The additional cost to employers as a result of the minimum employer contribution is estimated to be £3.4 billion per year once contributions have been fully phased in. This is equal to 0.6 per cent of labour costs. Table 1.2 shows what might happen to employer contribution costs over time if these costs increased in line with earnings growth.

Table 1.2 : Estimated total annual employer contributions in future years (principal scenario £ billion)				
	2020	2030	2040	2050
Employer contributions	**3.9**	**4.8**	**5.8**	**7.1**

Source: DWP modelling
Note: Figures are expressed in 2009/10 earnings and prices

- **Impact on employer administration costs:** The costs to employers of administering these regulations are estimated to be £443 million in the first year and £130 million each year thereafter for all firms. Annex G explains the methodology and assumptions behind these estimates.

Table 1.3: Estimated total cost to employers of administering the reforms (all firm sizes) (£ million)[63]		
	Year 1 cost	Ongoing cost in future years
Administrative costs	**443**	**130**

Source: DWP modelling.
Note: Figures are expressed in 2009/10 earnings and prices.

- The administration costs that each firm will face will depend on:

- ***Employer scheme choice*:** Employers will make a choice about whether they will enrol employees into existing pension schemes, a new pension scheme that qualifies under the quality requirements prescribed in the regulations or the personal accounts scheme. We estimate that those employers who choose to fulfil their new duties by extending their existing scheme will have lower administrative costs than those setting up a new qualifying scheme. This is because the majority of employers setting up a new scheme will not benefit from having pre-existing systems and experience of dealing with pension contributions. We expect that the majority of those setting up a new scheme, over one million firms, will use the personal accounts scheme.[64]

- ***Size of firm*:** The average administrative cost per employee is estimated to be lowest for larger firms and highest for micro firms. This reflects the fact that small firms are more likely to have to set up a new scheme and on average have lower

participation rates in existing schemes, and so will need to enrol a larger proportion of their workforce into a pension scheme. Larger firms are also able to spread the fixed costs associated with these regulations across a greater number of employees.

Regulations designed to minimise burden of additional costs on employers.

- There are a number of policies which help to reduce the burden on employers. These include: straightforward qualifying tests for existing schemes; allowing employers offering higher contribution schemes to operate postponement periods; a proportionate but effective compliance regime and a commitment to phasing in both employer and jobholder contributions; and
- In particular, the design of the implementation approach will benefit those employers with Defined Contribution (DC) schemes who are brought under the duties later. This benefits small and micro firms in particular as they are staged in later than larger firms. This not only gives these firms longer to prepare for automatic enrolment, but also provides the delivery authorities with an opportunity to test their systems before large numbers of smaller firms are brought under the duties. This approach also benefits new companies, who will be brought under the duties after the main staging of existing firms is complete. Table 1.4 shows that the annual contribution costs for all firms are lower in the years between 2012/13 and 2017/18 than the £3.4 billion they are estimated to be in steady state (2018/19).
- There are also transitional arrangements for those employers using Defined Benefit (DB) and hybrid schemes.[65] Employers offering such schemes will be able to delay automatic enrolment until October 2016 for those jobholders who have previously chosen to opt-out of such schemes.

Table 1.4: Estimated impact employer contribution costs to 2018/19 under proposed implementation approach (£ millions)

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Total costs	**20**	**300**	**630**	**840**	**1680**	**2860**	**3430**

Source: DWP modelling.
Note: Figures are expressed in 2009/10 earnings and prices and are rounded to the nearest £10 million.

- A staged approach can affect the ability of employers to compete with each other in the short-term as some employers will face the cost of administering the reforms and contributing to their employees' pensions sooner than employers staged later. The competition impact in part depends on how employers choose to cope with the reforms. For instance if employers cope with the cost of the reforms by increasing prices then they will experience a price differential from their competitors if those are staged in later. It is difficult to estimate this competition impact on employers without knowing the difference in staging time between employers that actively compete with each other.

Impact on pension industry

1.37 The impact of workplace pension reforms on the pension industry is discussed in Chapter 5. This chapter covers **four key points:**

The current pension landscape

- Membership of employer-sponsored DB schemes is in long-term decline and this trend is only partially offset by rising DC scheme membership. As employer contribution rates in DB schemes are higher than in DC schemes, shifts in membership towards the latter mean that employer contributions to pension schemes are falling. Meanwhile employee contributions to workplace pension schemes are rising. Contract-based schemes are also replacing occupational schemes. At present, charges in workplace pensions vary widely depending on characteristics of the employer, employees and features of the scheme or scheme type, but are generally lower than or equal to the stakeholder charging cap.

Impact of reforms on demand for pension provision

- Analysis by DWP, shows that approximately 750,000 employers who currently offer no workplace pension provision[66] will therefore need additional pension provision to comply with their duties under the Pensions Act, 2008; and 280,000 employers offer some provision but make less than a 3 per cent employer contribution and will need to increase pension contributions. This means a substantial increase in pension membership of 5 to 9 million people newly saving or saving more in all forms of workplace pensions.[67]

Impact of reforms on the supply of pension provision

- Existing providers will increase supply of pension provision in line with their profit maximising objectives taking into account how the reforms impact provider profitability. The reforms will also introduce the personal accounts scheme into the pensions market which will be a low-cost option designed to complement existing pension provision.

- Reforms to workplace pensions will impact on ***provider profitability*** in three main ways. They will affect the:
- ***The cost of provision*** going forward: high level results of a survey indicate that providers expect the ongoing costs of pension provision pre and post reform to be broadly the same.[68]

- ***Levels and rates of contributions being made***: Whilst automatic enrolment is expected to increase overall revenues, there are concerns that newly eligible employees who will be automatically enrolled were likely to be those who currently have no pension provision and may therefore have relatively low salary levels. Current data from ASHE shows that mean qualifying earnings for members in 09/10 earnings terms are £22,300 compared with £14,800 for non members. [69] Therefore, pension contribution per member for those newly saving may be lower compared with those members who are already in pension saving.

- Stakeholders also have concerns that employers that provide good pension schemes can reduce or 'levelling down' their contribution levels to the minimum requirements. At present this risk is low. DWP research with employers in 2009 shows that of those employers who make contributions of 3 per cent or more the vast majority (93 per cent) reported that they would maintain or even increase contribution levels for existing members.[70] The Government recognises this risk and is introducing a number of measures to mitigate it and will continue to monitor it as we approach 2012.

- ***Charges:*** The personal accounts scheme is expected to be a low-charge scheme. Until the details are finalised, it is difficult to fully assess the competition impacts on the pensions market. However, given experience with the Stakeholder Pensions cap discussed in 5.14, it is expected that the level and structure of charges set by the personal accounts scheme will inform the charging structure and level of other providers in the pensions market. The effect is likely to be pronounced in the part of the market where charges are already high due to member characteristics.

- ***Supply from pension providers:*** It is expected that pension providers with existing pension schemes will see an expansion in membership or an increase in contributions to meet minimum contribution requirements of around 3-4 million people newly saving or saving more in workplace pension schemes with current pension providers once the reforms are fully introduced.[71]

- Employers can choose to use ***the personal accounts scheme*** to fulfil their new duty. An estimated 3 to 6 million people will be saving in the personal accounts scheme, including some who were previously saving in existing forms of workplace pensions and some who opt-in.

The impact of workplace pension reforms on customer outcomes in pensions market

- The current nature of demand for pensions means that there is little pressure on the current market to deliver better consumer outcomes in terms of lower prices and better quality products. The introduction of workplace pension reform provision can improve present market outcomes for customers. In particular the personal accounts charging regime is intended to deliver better consumer outcomes to those who do not have access to a low cost scheme in the current pensions market. It may lead to a more diversified product range as providers focus on differentiating their products from the personal accounts scheme.

Competition Impact

1.38 Annex B covers the competition impact of the reform. It covers the impact of workplace pension reforms on competition in **four key areas**:

Impact on labour and product markets

- The reforms may have competition impacts on labour and products markets depending on how employers choose to cope with the reforms. There will also be

additional competition impacts in the short term as a result of the implementation design. The reforms may have additional impacts on the financial advice market but the overall effect is difficult to comprehensively define because of changes expected in this market (such as the outcomes of the Retail Distribution Review) before the reforms are introduced.

Impact on pensions market

- Overall the reforms are expected to lead to a long-term expansion in workplace pensions. Providers and intermediaries recognise that the personal accounts scheme is designed to complement existing personal and occupational pension provision. Concern still exists, however, about the possible impact of the personal accounts scheme on the rest of the pensions market [72] - however our analysis suggests that this may not be a significant issue. It is expected that the personal accounts scheme will have different competition effects across the pensions market.

- In the part of the pensions market where existing pension provision is limited, the personal accounts scheme is expected to have a large share of the pensions market. Existing providers are unlikely to actively compete with the personal accounts scheme in this part of the market because of high costs in this area which may increase further following reform due to characteristics specific to this part of the market for instance if a large number of new savers opt-out. Pension contributions of those newly saving in this part of the market will also be lower than those who are already saving in pensions.
- The competition effect on the market where profitability is higher will be beneficial, for instance for those employers with a large number of members who are higher earners. In this part of the market other pension providers will be able to offer low charges and tailored products in order to actively compete with the personal accounts scheme.
- The extent to which the personal accounts scheme will attract provision from existing pension providers will also be limited by the cost to employers of switching provision. Employers that currently offer a pension scheme to their employees (with or without an employer contribution), report that they would continue to use this existing scheme rather than change to different providers such as the personal accounts scheme as this will cost them more time and administrative burden.[73]
- In addition, the personal accounts scheme has a number of features to minimise any possible impact on the existing pension industry. These include setting an annual contribution limit and a general prohibition on transfers between the personal accounts scheme and alternative pension vehicles. These measures will be reviewed in 2017.
- Overall, the introduction of workplace pension reforms is expected to improve customer outcomes in the pension market and lead to lower charges and a more diversified product range.

Impact on services market which supply the personal accounts scheme

- The trustees of the personal accounts scheme will work in the best interests of members to ensure low charges, ensuring that firms compete for time-limited contracts. In the short run, the nature of competition will be different in the personal accounts scheme than in the overall market, with providers competing for contracts to serve this segment of the market rather than directly for consumers. In the long run any potential losses of dynamic efficiency gains and product innovation will be mitigated by contract specifications and periodic renewal.

Impact on non-pensions saving products

- An estimated 30 to 50 per cent of additional savings in workplace pension reforms are expected to be diverted from existing savings products.[74] This offset rate is expected to be lower for those on lower incomes as they will have low levels of existing savings.

Impact on Government

1.39 Chapter 6 discusses the direct and indirect impact of the reforms on Government finances. It covers **four main areas**:

Costs of implementing the workplace pension reforms

- These include the costs incurred by the Personal Accounts Delivery Authority (PADA) and the Trustee Corporation; the cost of setting up and maintaining the Employer Compliance Regime (ECR); the costs of communicating the reforms to employers, individuals and existing pension providers; and the administrative costs of developing the policy and running the programme management office.

Impact on the Exchequer of granting tax relief

- On higher individual and employer pension contributions. The additional annual cost to the Exchequer of tax relief on individuals' pension contributions is expected to be around £1.3 billion in 2009/10 prices once contributions are fully phased in. The impact on the Exchequer from increased employer contributions to workplace pension schemes is expected to be a further £850 million in 2009/10 prices once contributions have been fully phased in.[75]

Impact on the Exchequer of expenditure on tax credits and other income-related benefits

- Approximately 2.3 million family units are in receipt of tax credits with at least one member eligible for automatic enrolment. Of these, around 30 per cent would see a small change to their tax credit. Around 240,000 jobholders who are in receipt of an income-related benefit (Income Support, Council Tax Benefit, Housing Benefit or Income-based Jobseekers Allowance) will be eligible for automatic enrolment. Of these around half are also in receipt of tax credits. Some of these individuals will also be entitled to a higher benefit award, but the total impact on the Exchequer is expected to be small.

- The increase in private pension saving due to these reforms is expected to reduce reliance on income-related benefits in retirement. Assuming current benefit rules continue to apply, by 2050 around £1.3 billion per year (2009/10 prices) less might be spent on Pension Credit, Housing Benefit and Council Tax Benefit. This compares to £11-14 billion extra generated in additional private pension income in the same year.

Cost to Government as an employer

- The costs to public sector organisations of additional pension provision have not been estimated in this impact assessment but we expect them to be small as pension provision and membership in the public sector is high. The Annual Survey of Hours and Earnings shows that the majority of public sector employees are members of an employer sponsored scheme (80 per cent of 5.5 million employees in 2008.[76] Of these an estimated 600,000 individuals working in the public sector will be eligible for automatic enrolment.[77]

Monitoring and Review

1.40 The programme intends to fully evaluate the effects of the reforms against the policy objective of getting more people to save more for retirement. The evaluation will also assess the impacts of the reforms on employers and the pensions industry, to evaluate the extent to which we meet this policy objective whilst putting minimal burden on employers and maintaining current good pension provision.

1.41 The effects of the reforms will be evaluated through analysing a range of data, including Management Information from TPR and the personal accounts scheme, existing continuous surveys of individuals and employers run by DWP and other Government Departments such as the Office for National Statistics and where appropriate, research commissioned by DWP. As such, the evaluation will be conducted by a combination of external research organisations and academics and DWP analysts. The evaluation will be carried out on an on-going basis to gauge progress throughout the implementation of the reforms and beyond, and findings will be available publicly at key stages.

1.42 In addition to the evaluation of the reforms, in 2017 DWP will review those features of the personal accounts scheme that are designed to focus it on the target market, specifically the annual contribution limit and the prohibition of pension fund transfers to and from the scheme. The evaluation of the reforms will feed into this review, as appropriate.

Appendix 1: Summary impact of regulations

Pension Regulation	Impact on employers	Impact on individuals	Impact on pension industry
Enrolment information	Employers incur a cost of providing the prescribed information to the jobholder and their pension scheme. This cost is included in the estimates of ongoing administration costs associated with the reforms.	Employers will provide written information to the jobholder which will help the individual to decide whether to stay in the pension scheme or to opt-out.	Employers must provide information to their scheme or provider about jobholders. This includes minimal essential information which must be provided to support active membership to be achieved, and more detailed information which may be provided if required by the specific scheme or provider. This does not impose costs on pension schemes.
Opt out window and opt out process	The opt-out process imposes the cost of issuing the opt-out form (on request) to jobholders where for occupational pension schemes this administrative function has been delegated by the trustees to the employer in the trust deed. The process also specifies an opt-out period which gives employers more certainty around when jobholders can opt-out and the administrative arrangements for this.	The opt-out process is designed to support an individual's decision not to save if it does not suit their personal circumstances. This includes setting the opt-out period at one month and giving individuals the flexibility to obtain the opt-out form from the scheme or the employer where occupational pension schemes have delegated the administrative function in the trust deed.	Pension schemes will need to provide the opt-out form in most cases.
Refunds	The refund process detailed in the regulations makes it the employer's duty to refund contributions to the jobholder independent of when an employer receives money back from the scheme. The administrative cost of making refunds is included in the administrative cost to employers in Chapter 5.	Individuals who do choose to opt-out of pension saving are treated as never having been a member and are entitled to a full refund of any contributions they may have made within a prescribed time limit. This is the employer's duty irrespective of whether they get the contributions back from the scheme.	The pension scheme also has a requirement to refund any contributions paid by or on behalf of the jobholder to the employer within a prescribed period. Refunds will create additional costs because jobholders may have to be entered onto the providers systems as part of automatic enrolment process, and then removed, without any pension contributions being received by the provider from the member.
Pay reference periods	Pay reference periods of 12 months are designed to help employers identify when a worker is a jobholder and, if so, to calculate the contributions to which they are entitled. Employers can	Pay reference periods help to ensure minimum contribution requirements and policy intent of increased retirement saving for individuals is met.	Setting a pay reference period of 12 months allows employers and schemes to assess, at the end of the year, whether pension contributions paid meet the minimum level requirements.

	use a process of annual reconciliation to assess at the end of the year whether the pension contributions they have made meet the minimum level requirements. It helps to minimise burdens on employers by enabling schemes to maintain their existing definition of pensionable pay.		This means that schemes will be able to continue to use their own definition of pensionable pay and if scheme rules need to be changed at all, they will simply need to reflect a requirement for a balancing payment to cover any difference between contributions calculated and paid on the basis of pensionable pay and the contributions due on the basis of qualifying earnings. This should go some way to easing the burden on schemes.
Automatic re-enrolment	Employers will be required to re-enrol eligible jobholders who opted-out at the initial automatic enrolment date or those who subsequently cancelled their membership into a qualifying scheme. This imposes additional cost for employers. The timing of re-enrolment is set around three years from the date employers will be staged into the reform. This minimises the burden on employers as there is one re-enrolment date for all jobholders within each firm. There will be an exemption whereby jobholders who have recently opted-out or cancelled membership will not need to be re-enrolled. This places an additional burden on the employer as they will be required to identify individuals who are exempt and therefore do not have to be automatically re-enrolled. However, it minimises employers having to process opt-outs that are more likely to occur because these individuals' circumstances are less likely to have changed.	Pension saving may not have been the right choice at the point the jobholder opted out. In the meantime their earnings may have increased, financial commitments may have reduced or their priorities may simply be different. Re-enrolment aims to maximise pension savings and reduce decision-making inertia. Those individuals who still do not wish to be in pension saving will need to go through the formal opt-out process again.	Re-enrolment increases membership and persistency in the pension scheme. The exemption whereby jobholders who have recently opted-out or cancelled membership will not need to be re-enrolled minimises the number of opt-outs and refunds that schemes need to process, as these individuals' circumstances are less likely to have changed. Re-enrolment may increase the number of queries coming to providers and schemes.
Voluntary Savings	Employers will face additional administrative and	This policy is designed to maximise individual	These regulations can increase membership in

	contribution costs of auto-enroling those jobholders aged 16 to under 22 or state pension age to 75 who have qualifying earnings and choose to opt-in. It is difficult at this stage to estimate numbers. Employers will face administrative costs of facilitating access to a scheme for workers earning less than £5,035 if the individual notifies their employer in writing that they want to opt-in. Employers, however, are not required to make pension contributions for these individuals. Any individual can use any form of written request to the employer to opt-in to the scheme.	saving. These regulations provide an accessible pensions savings product for individuals not eligible for auto-enrolment, self-employed people and for members of the personal accounts scheme who wish to continue to save during periods out of paid work, for example if they take a career break due to caring responsibilities. There is a provision to ensure workers are able to opt-in at least once in every 12 month period. This is to maximise saving for those individuals who opt-out of automatic enrolment or who cancel their membership of a scheme, to change their mind and re-apply to join to reflect any changes in their circumstances.	pension schemes and increase total contributions. Contributions per member however, are likely to be lower as people aged below 22 and above the state retirement age, self-employed and those that earn below the lower earnings limit have lower average salaries.
Employer duty to maintain active membership:	Employers are allowed one month between the end of active membership in the original qualifying scheme and the start of active membership in a replacement scheme. This allows the employer to carry out the necessary administrative processes without being in risk of breaching their duties as a result of a technical delay.	A jobholder with median earnings with eight one month gaps in pension contributions would face a maximum reduction in total fund size of 2 per cent over an average individuals lifetime compared to an individual who experiences continuous contributions throughout their working life.	This does not have a significant impact on pension providers.
Quality requirements of qualifying schemes	Employers will be able to use a range of qualifying schemes to meet their duties including existing provision. Employers can determine whether their DB scheme meets quality requirements in straightforward cases,	Supporting existing pension provision is beneficial for individuals already in pension saving.	Quality requirements for qualifying schemes have been designed to support current pension provision and aim to build on existing good provision already in place.

	whereas an actuary (by making projections and assumptions about earnings growth and other related factors) could make the determination in more complex cases. DC schemes will need to meet a simple contribution level test as laid out in the Pensions Act 2008. These minimal requirements should make it easier for employers to continue with their existing provision. Allowing non-UK schemes to be used as qualifying schemes helps to minimise burdens on employers by encouraging them to maintain existing non-UK based provision where appropriate.		
Postponement periods	An employer may postpone the automatic enrolment of a given jobholder into a pension scheme for up to three months provided they subsequently automatically enrol their jobholder into a workplace pension scheme and contribute at least 6 per cent[78] of qualifying earnings[79] for a minimum of three months following the postponement period, and provided they have not already postponed automatic enrolment for that individual in the previous 12 months. The rationale for permitting employers to postpone automatic enrolment is to encourage them to maintain more generous provision by providing a way to reduce administrative and contribution costs. Employers in sectors with high turnover are the most likely to benefit from cost savings as a result of a postponement period.	Individuals in sectors with high turnover rates are the most likely to be affected by the postponement period. Where consecutive contracts are prevalent, the risk of continual postponement is reduced by the requirement that an employer may not postpone if a jobholder has already been postponed in relation to other employment with that employer within the last 12 months.	Postponement helps to decrease the risk of employers reducing their contributions to the minimum requirement.
Occupational and Personal Pension Schemes (19 day	Employers must refund jobholders who have opted-out of automatic enrolment	The 19 day rule change proposed in the Government	Employers must refund jobholders who have opted-out of automatic enrolment

rule) regulations	within a certain timeframe. An amendment to the 19 day rule (concerning the deadline by which employers must pass employee contributions over to the scheme) will allow employers to delay paying over jobholder contributions to the scheme until the last day of the second month following the month in which automatic enrolment occurs This will minimise any refunds of contributions for individuals who opt-out during the opt-out window by the employer.	consultation document is estimated to have less than a one-hundredth of a percentage point impact on individual savings.[80]	within a certain timeframe. Changing the timeframe in which employers must pay jobholder contributions to the scheme for the duration of the joining window and the opt-out period minimises the need for refunds from scheme to employer minimising costs of opt-outs and risk of investment loss of contributions that have to be refunded.
Hybrid Scheme Quality Requirement Rules	There is no specific quality test for hybrid schemes as employers will be directed to the DB or DC scheme quality requirements. These quality requirements will sometimes be modified and/or combined in accordance with the benefit structure of the scheme so that they can be applied in a relatively straightforward way, thus minimising burdens on employers whilst protecting individual saving.	Supporting existing pension provision is beneficial for individuals already in pension saving.	Quality requirements of qualifying schemes have been designed to support current pension provision and aim to build on existing good provision already in place.
Employer Duties (Implementation Regs)	The implementation approach means that employers will face less contribution costs during the implementation period. These cost savings are discussed in Chapter 4. The implementation design also has a short term competition impact as employers face the increased cost of administering the reforms and making employer contributions at different points in time. This is discussed more fully in Chapter 4.	A staged approach to these reforms (which is operationally viable) delays mandatory contribution requirements of at least 8 per cent of qualifying earnings till October 2017. This approach will have an impact on pension saving of those individuals that are automatically enrolled during the implementation period. To illustrate the impact, in, it is estimated that an individual staged in August 2016 could have a pension pot 3.5 per cent lower than if the individual had been staged in October 2012. [81]	The staged approach will allow the pension industry time to prepare their systems and processes for the expansion in pension provision. It is estimated that an additional 3-4 million people will be saving or saving more in existing pension schemes. The implementation approach, in particular phasing of contributions, can limit short-term profitability for the pension industry. This is because returns to a scheme are lower than if employers were required to make 3 per cent contributions from their automatic enrolment date.

		Employers are able to start making contributions, should they wish to do so, ahead of the date which they are due to be staged in.	
Registration & re-registration	The costs of registration and re-registration are included in the estimates of costs of administering the reforms and are discussed in Chapter 4. To minimise employer burdens at registration and re-registration, TPR will require only the key information it needs to deliver an effective compliance regime. To make the process as simple as possible TPR will encourage electronic registration, but will accept telephone or paper registration.	This does not have a significant impact on individuals other than to support compliance which in turn protects individual saving.	These do not have a significant impact of pension providers other than to support compliance which in turn protects total pension saving.
Record keeping	Some of the records that employers are required to keep, so that TPR can check compliance with employer obligations, will impose additional costs for employers. The costs of record keeping are included in the estimated costs of administering the reforms. Many of the records will already be maintained for other purposes such as tax and payroll. Research with employers on the detail of these regulations viewed the record-keeping requirements easy to comply with as they need to keep copies of document anyway.[82] There will be no requirement to hold separate, duplicate records where a pension scheme carries out delegated administrative functions on behalf of its sponsoring employer, or the employer uses the services of a third party administrator.	This does not have a significant impact on individuals other than to support compliance which in turn protects individual saving.	Schemes and providers will be required to keep records of enrolment and information relating to individual scheme members for six years, and the incidence of opt-out for each employer for four years. While schemes are already required to keep records relating to their members, the requirement to keep records of jobholders who opted-out of membership will impose additional costs on pension schemes There will be no requirement to hold separate, duplicate records where an employer carries out delegated administrative functions on behalf of its pension scheme, or where the scheme uses the services of a third party administrator. There will be flexibility around the format in which pension schemes must keep these records, for example electronic or paper format.

	To minimise employer burdens there will be flexibility around the format in which employers must keep these records, for example electronic or paper format.		
Compliance	The compliance regime will facilitate compliance and prevent employers who do not comply from gaining an unfair economic advantage over their competitors.	The compliance regime protects individual savings.	Maximising compliance to workplace pension reforms increases total pension saving.
Personal Accounts Order and Rules	The personal account scheme is one type of qualifying scheme the employer may choose to meet their employer duties.	The personal accounts scheme is a low-cost scheme targeted towards low and moderate earners.	The impact of the personal accounts scheme on existing pension industry is discussed in Chapter 5 and Annex B.
Trustee Corporation	This does not have an impact on employers.	The winding up of the Trustee Corporation does not have an impact on individuals.	The winding up of the Trustee Corporation does not have an impact on pension industry.

Chapter 2: Impact on the macro-economy and labour market

Background

2.1 This chapter considers the impact of the reforms on the economy and the labour market. **It covers four key areas:**

- The impact on the macro economy including the increase in overall savings and the effect that has on economic growth in the short-term and long-term; [83]
- The increase in social welfare as individuals spread their income over their lifetime. This is the most significant effect of the reforms;
- Impact on the labour market including changes in employment which depend on how employers respond to increases in labour costs;
- Likely interactions between the reforms and the economic downturn in 2008 and 2009.

Impact on the macro-economy

2.2 Increased pension saving has a small positive effect on the economy. If total economic resources increase, more income is potentially available to individuals for consumption. National income is either measured by the Gross Domestic Product (GDP) or Gross National Product (GNP).[84]

Increased saving

2.3 DWP's principal estimate is that a policy of automatic enrolment and mandatory contributions from individuals and employers will generate pension savings of up to approximately £9 billion per year by 2020.[85]

2.4 Of these, an estimated 50 to 70 per cent of savings are expected to represent additional household saving.[86] This is equivalent to less than half of one per cent of Gross Domestic Product. This estimate is based on a review by Pricewaterhouse Coopers of relevant UK and international evidence. The report compares particular features of the reforms to workplace pensions planned in the UK with other experiences to estimate that households are likely to offset 30 to 50 per cent of savings in pensions from existing sources of saving. These features are:

- **Automatic enrolment** which is more similar to schemes in which pension saving is mandatory rather than voluntary although individuals can opt out of pension saving.
- **Matching employer contributions and tax relief** which are more likely to generate additional saving; and
- **Lower and middle income earners** are the target of the reform and are more likely to increase total saving as a result of the reforms.

2.5 DWP continues to monitor international evidence to inform its saving estimates.[87] Experiences in other countries of similar schemes based on automatic enrolment have been different. For instance, only 9 to19 per cent of savings generated from the Kiwisaver scheme in New Zealand has been in addition to existing saving and have and not shifted from other assets.[88] The low level of additional savings generated by

the KiwiSaver may be attributed to particular features of the scheme which distinguish it from reform to UK workplace pensions. [89]

Effects on economic growth

2.6 The increase in total pension saving is estimated to have a small positive effect on economic growth. In 2006 DWP commissioned the National Institute of Economic and Social Research study (NIESR) to simulate the effect of the introduction of workplace pension reforms on the macro-economy. The results of the study (shown in Figure 2.1) found that the effect on the economy was small and positive in all potential scenarios considered. The assumptions behind the modelling and results are discussed in Box 2.1.[90]

2.7 In the model, the reforms are expected to increase saving which reduces consumption in the short-term as people have less disposable income. In 2015, the effect of lower consumption is a reduction in output by less than 0.15 per cent, which is the cumulative effect of annual impacts so small that they are unlikely to be detectable (below 0.05 per cent).

Box 2.1 Estimating macro-economic impact of the reforms

The DWP asked the NIESR to help model the impact of the reform package by using NiGEM, their macroeconomic model for the UK and world economy. NiGEM is a large estimated quarterly model of the UK and the world that is intended to capture the key features of the economy. It is theoretically coherent and quantified by means of empirical estimation and calibration over recent historical experience. It provides a plausible benchmark for estimating the effects on the economy of a range of different scenarios.

It is set in a New-Keynesian framework where agents are forward looking, but nominal rigidities, namely sticky prices and adjustment costs, slow down the adjustment to the long-run equilibrium. It includes complete demand and supply sides, as well as extensive monetary and financial sectors. Domestic demand, aggregate supply, and the external sector are linked through the wage-price system, income and wealth, the financial sector, the Government sector, and competitiveness. The external sector links the UK domestic economy to the rest of the world.

To simulate the introduction of pension reforms in NiGEM and its impact on additional savings (estimated to be 60 per cent of estimated contributions), the model effectively lowered the Marginal Propensity to Consume (MPC), a variable that describes what proportion of income is spent on consumption, in the equation that determines consumption behaviour. The relevant equation in NiGEM is:

$C(t) = (\ \Theta + \rho) * (\ HUW(t) + NHW(t))$,

where HUW is human wealth and NHW is financial and housing and asset based wealth. The MPC is made up of the premium on the future (Θ) and the probability of death (ρ). The higher Θ and ρ, the less important is the future, and, therefore, the higher current consumption will be.

This implies that, all else being equal, individuals will save more at every level of income. The

rationale behind this from a modelling point of view is that introducing automatic enrolment will change what could be considered a sub-optimally high MPC. This change in the MPC would be the result of overcoming some of the underlying psychological barriers to saving, such as inertia and myopia, whilst providing a new simple low-cost savings vehicle to invest pension contributions efficiently.

The savings increase associated with the introduction of the reforms implies lower consumption in the short-term, which initially has a downward effect on economic activity. The small decrease in GDP compared to the baseline from 2012 onwards is caused by the initial savings increase, which results in lower consumption in the short-run.

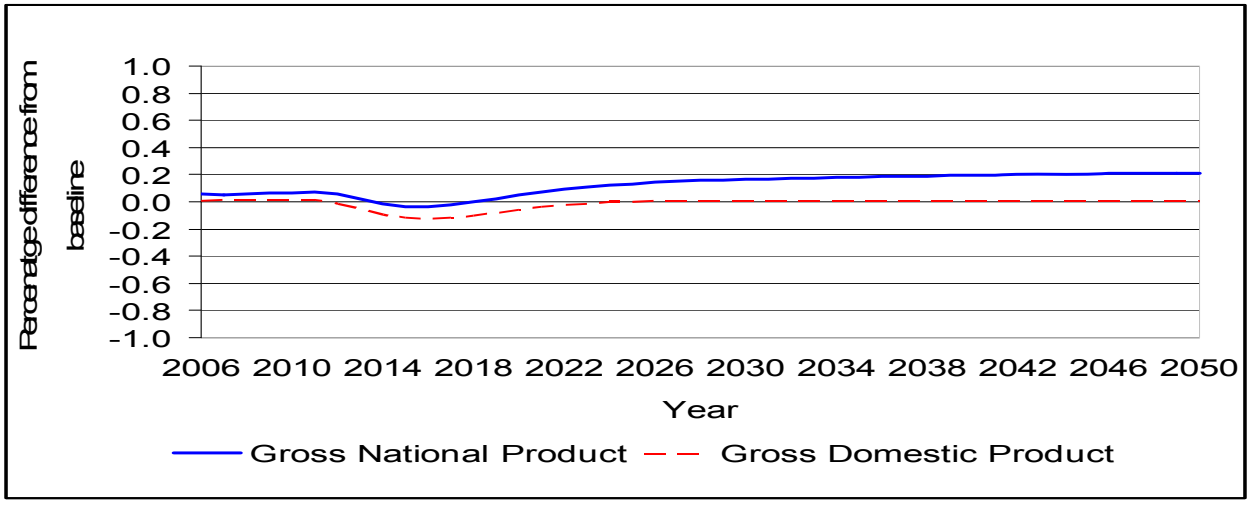
The economy then gradually reverts back to the original growth path as it adjusts to the new level of savings in the economy. It should be emphasised that all of the changes described here are very small. For example, the cumulative downward effect does not go beyond 0.15 per cent, and the largest impact on economic growth in any given year remains below 0.05 per cent, a magnitude that is not likely to be detectable in practice.

GNP is higher and settles around 0.2 per cent above the base case. The reason that GNP is higher than GDP in this projection has to do with the fact that it includes investment income received from abroad. NiGEM models the UK as a small open economy in which investment decisions are taken independently from the domestic savings decisions. If, as in this case, the domestic supply of savings increases without a fundamental change in the profitability of investment, most of these savings will go abroad. This in turn leads to a build-up of foreign capital. The associated investment returns that flow back do not show up in the GDP measure of economic activity but are reflected in GNP.

Source: van de Coevering et al. (2006) *Estimating economic and social welfare impacts of pension reform*. DWP Pensions Technical Working Paper. Available at: http://www.dwp.gov.uk/pensionsreform/pdfs/DWPTechWorkingPaper.pdf

2.8 In the long run, in the NIESR modelling the extra savings from the reforms result in incomes rising by an estimated 0.2 per cent as measured by Gross National Product, due to the extra investment income received from abroad.[91]

Figure 2.1: The impact of the reforms on economic activity



Source: National Institute of Economic and Social Research (NIESR). Note: The figure shows the difference in percentage points compared to the base case for the central modelling scenario.

Impact on Social welfare

2.9 The reforms will enable people to transfer income from their working life to increase their income in retirement. Individuals invest in a pension at a time when they have relatively more income in order to set money aside for when they have less income (retirement). This is known as consumption smoothing and is explained in more detail in Box 2.2.

Box 2.2: Consumption smoothing

In economics, 'consumption smoothing' means transferring consumption from a period in someone's life where they can afford to consume a lot to one where they could afford to consume only a little. In the context of pension saving, this means an individual forgoing a fraction of their income during their working life to have more income in retirement. The reason why 'consumption smoothing' is beneficial is that most people value individual units of consumption, say, a meal in a restaurant, more highly in times when they can afford fewer of them. This is based on the concept of diminishing marginal utility; this says that the additional increase in well-being from an extra unit of consumption falls as individuals consume more of a given item. Hence, transferring some income and thereby consumption from a time with relatively high income (working life) to one with a relatively low income (retirement), can represent a net gain in an individual's well-being.

Our current working assumption is that following these reforms there will be 5-9 million people newly saving or saving more for retirement and therefore able to smooth their consumption more effectively. As a result, the expectation is that society as a whole will feel substantially better off[92]. While this will not be the same as an actual increase in financial wealth, we estimate that this welfare effect could have a magnitude equivalent to several tens of billion of pounds.

2.10 According to the methodology set out in a DWP technical working paper[93] which has been updated to account for the uncertainty surrounding some of the assumptions, the impact of consumption smoothing will be to increase social welfare by around £40 to 60 billion for the period up to 2050. The methodology and assumptions are summarised in Annex H. This amount does not represent a financial transfer but represents the value to individuals from transferring income from more affluent times to retirement.[94]

Impact on the labour market

2.11 The regulations will lead to increased contribution and administrative costs to employers. The magnitude of these costs in relation to each employer will depend on the nature of their existing pension provision, current participation levels and how they choose to comply with the duties. These costs are discussed more fully in Chapter 4.

Increased labour costs

2.12 Based on the current labour market structure, the weighted average increase in labour costs across all industries is estimated to be 0.6 per cent.[95] This is lower than the minimum employer contribution rate of 3 per cent because:

- Not all employees will be automatically enrolled into workplace pensions and of those that are, around 25 per cent are estimated to opt-out[96];
- Earnings are defined as being post National Insurance Contributions; and
- Some labour costs are exempt from pension contributions (including earnings below the lower band of £5,035 and above the higher band of £33,540 as well as other employee benefits).

2.13 The costs of reform vary across industries:

- They are naturally concentrated in industries with higher levels of employment. The largest industries in terms of number of enterprises and employees are in the Business Activities, and Wholesale sectors. The estimated increase in labour costs as a result of the reforms for these industries is between 0.6 and 0.8 per cent.
- The proportional costs for reform is greatest for those industries which currently have low levels of existing pension provision such as the agricultural sector. For these businesses, the increase in labour costs is estimated to be around 1.2 per cent.
- The Financial intermediation sector experiences the lowest percentage increase in labour costs as a large proportion of employees are already members of pension schemes that meet quality requirements for schemes.[97]

Estimating the impact on Employment

2.14 Employers may pass on the full cost of the employer contribution to employees by reducing wages or other non-wage benefits in order to absorb the cost of additional pension contributions. By doing this, there would be no employment impact.[98]

2.15 However, employers may not be able to pass all costs to employees because of rigidities in the labour market (for example due to National Minimum Wage, or industrial arrangements). Therefore, particularly in the short-term, employers may have to use alternative coping mechanisms such as absorbing costs into their overheads or raising prices.

2.16 The extent to which employers are able to absorb increased labour costs through overheads or prices will depend on the level of competitive pressure that enterprises face. In domestically dominated markets these constraints are less binding, since all UK enterprises will be subject to the employer duty. However, enterprises that compete in international markets against non-UK firms may be less able to increase prices or reduce their profit share.

2.17 It is difficult to know the exact effect the reforms will have on employment without knowing how employers respond to the reforms when they are implemented. However, the potential labour market impact of the reforms can be estimated based on reasonable assumptions using:

- **Elasticity of labour demand to changes in non-wage labour cost**. While this estimate is likely to vary across different types of employers, a reasonable assumption is an elasticity of -0.5.[99] This implies that a 1 per cent increase in labour costs will result in 0.5 per cent fall in employment. Using this estimate of the elasticity of labour demand to increases in non-wage labour costs suggests that in the long-run workplace pension reforms can reduce employment by around 70,000.[100]

- **Findings from employer attitude surveys** on what they are most likely to do in response to the reforms. Using this, the employment impact of the workplace pension reforms on employment is estimated to be between 10,000 and 80,000 or a reduction of between 0.1 to 0.4 per cent in private and not- for- profit employment. [101] The lower estimate is based on employer responses in which 8 per cent of employers said they could restructure or reduce employment. The higher estimate is based on the responses of a very small proportion of employers who reported that their most likely response would be to close their firms.

Economic Downturn

2.18 The financial recession of 2008 and 2009 may well have had an adverse impact on public confidence in financial products and the willingness of employers and employees to participate in these reforms.

2.19 Against this context, DWP commissioned the National Institute of Economic and Social research to carry out research to assess if recent economic developments had made any difference to the appropriateness of policy goals to increase private retirement saving, particularly through the workplace pension reforms.

2.20 The reports, as detailed in Box 2.3, find that the UK net national savings[102] have been low in the last twenty years compared with earlier periods and with other advanced countries, even taking account of the changing age structure of the population and rising life expectancy. This rate is too low - measured either by calculating the savings rate needed to hold the ratio of wealth to income constant, or by looking at the rate of saving required - for each generation to pay its way.

2.21 The research concludes that policies to raise savings, such as workplace pension reforms, are appropriate and the current recession does not have a substantial impact on the rationale for the introduction of workplace pension reform

2.22 At present, independent forecasts collated by HM Treasury in November 2009 show that, on average, experts are expecting Gross Domestic Product growth of 2.3 per cent in 2012 and 2.7 per cent in 2013.[103] This means that the economy is set to recover before the reforms are introduced.

Box 2.3 Economic downturn and rationale for workplace pension reforms

As part of the programme of research to assess if recent economic developments would make any difference to the appropriateness of the policy goal of increasing private retirement saving NIESR produced four papers. These included:

- An analysis of national saving including a historical perspective of different sources of saving and an assessment of different ways of considering saving adequacy;
- A macroeconomic analysis of the effects of asset prices on saving;
- A microeconomic analysis of the effects of asset prices and rising unemployment on saving; and
- A summary assessment of the policy objective of increasing retirement saving in the light of the above evidence.

By analysing different definitions and measures of income and saving, and examining the UK saving rates on both international and historical views, NIESR found that:

- National savings, including savings by household, corporate and Government, will determine future national income and thus consumption opportunities;
- National savings can be measured in different ways according to how they treat capital gains. However, it is better to exclude capital gains when examining the savings of a country in long run, since these capital gains are transfers of resources from future generations to the current;
- UK net national savings have been low in the last twenty years, compared with both its own earlier period after World War Two and other OECD counties; and
- Current UK savings rate is too low, either simply measured by calculating the savings rate needed to hold the ratio of wealth to income constant, or by looking at the rate of saving required for each generation to pay their own way. With assumptions of a real interest rate of 4 per cent p.a. and a growth rate of 1.5 per cent p.a., neither today's twenty-year-olds nor the adult population as a whole can afford their actual consumption without saving more.

NIESR suggested that retirement financing requires a balance between state pensions financed by people of working age through tax and benefit systems, and individual savings during their own working lives. Considering the historical low of the UK national savings rates, the changing age structure of the population and its rising longevity, policies to raise savings rates are very timely.

NIESR then examined the pension reform policies under the current recession and concluded that:

- The current recession does not have any substantial impact on the rationale for the introduction of the pension reforms. The Government should continue its reform schedule to meet the long-term saving needs of the economy;
- To achieve the short-term benefits of demand stimulus, it is better for the Government to use fiscal means, which take long-term savings arrangements as given, than for it to weaken its message on long-term saving;

However, the recession may affect people's willingness to save in pensions and raise their preferences for liquidity.

Source: Barrell and Liadze, 2009, Comparative Analysis of Consumption and Saving in the UK and US ; Ven van de and Weale 2009, Consumption, Employment Uncertainty, and Capital Losses; Weale 2009, Pensions Policy and the Recession. National Institute Discussion Papers 340, 344, 345, 346

Chapter 3 Impact on Individuals

Background

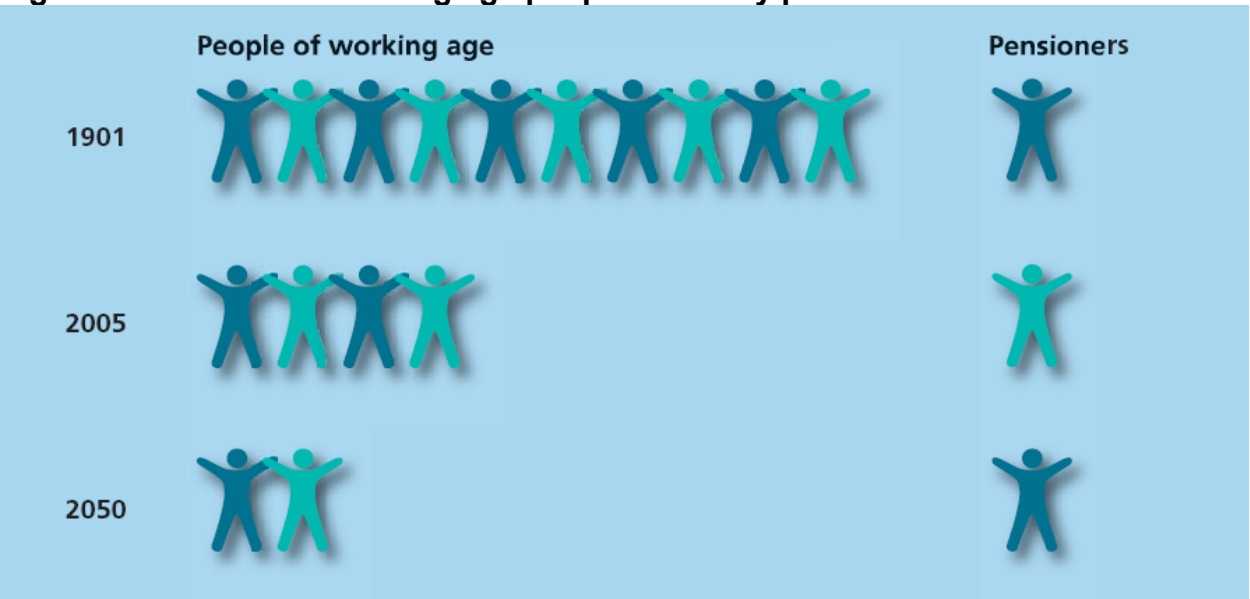
3.1 The UK pension system is facing a number of challenges.[104]

- People are living longer and fertility rates are low, meaning the proportion of the population aged 65 or over is rising rapidly. Figure 3.1 shows an expected doubling of the 'dependency ratio' between 2005 and 2050, with four working-age people supporting every pensioner in 2005, but only two in 2050.[105]
- A higher dependency ratio means that, unless people have saved enough for their retirement, there is a high cost to those who are working to maintain the pensions of the economically dependent.
- Around 7 million people are not saving enough to deliver the income they are likely to want or expect in retirement.[106]

3.2 Individuals on low to moderate income are more likely than other workers not to be saving enough for their retirement. The main reasons for not saving enough are that most people do not have a good understanding of pensions or the benefits of saving for retirement. This lack of understanding is made worse by a tendency to live for today rather than save for the future. As discussed in more detail in Chapter 1, even if people know they need to save, many do not get around to it. The overall proportion of working-age employees saving towards their retirement is falling (see Figure 1.1 in Chapter 1) with 44 per cent of working age employees not contributing to a private pension in 2005/06.

3.3 There is a lack of suitable pension products for low and moderate earners who are more likely to face higher prices for pension products than higher earners. The price of pension products has a large impact on incomes in retirement. For example, a median earner with a full savings history saving in a scheme with charges at the stakeholder pension charge cap would lose more than 30 per cent of their potential fund in administrative charges.[107] If they had instead saved in a scheme charging a 0.5 per cent annual management charge (AMC), they would lose around 12 per cent of their potential fund to charges.

Figure 3.1 Number of working age people for every pensioner



3.4 Without Government intervention, the number of people saving for their retirement and the levels of pension savings are unlikely to increase. This chapter considers the impact of workplace pension reform on getting more people to save more for their retirement.

3.5 The chapter covers **three key areas**:

- The impact of pension regulations on individuals including the number of new savers, the amounts of new saving and the impact on income in retirement.
- Regulations designed to protect individual savings; and
- The negative impact of specific regulations on individual savings in the short term.

Impact of pension regulations on individuals

3.6 This chapter sets out analysis and research evidence showing that:

- Almost seven in ten people report they will stay in and save when automatically enrolled into a workplace pension;
- The reforms will result in an estimated 5 to 9 million people newly saving or saving more in all forms of workplace pensions;
- Individuals will make estimated pension contributions of £4.5billion (2009/10 earnings terms) a year once contributions have been fully phased in;
- The reforms will increase private pension incomes by around £5 billion to £7 billion a year by 2050 (in 2009/10 earnings terms); and
- Most people (95 per cent) will get back more in retirement than they put in to pension saving in real terms.

3.7 Chapter 5 discusses the impact of the reforms to workplace pensions, including the introduction of the personal accounts scheme, on the range and prices of pension products available to individuals.

Impact on number of new savers

Automatic enrolment

3.8 Automatic enrolment is one of the most effective joining techniques to overcome people's tendency not to act when faced with difficult financial decisions. It overcomes inertia that can exist in private pension saving, whereby many individuals do not make the decision to start saving even when they are aware of the need to do so.[108] Automatic enrolment creates a presumption to save and will make it easier for workers to do so, while retaining the opportunity for them to opt-out.

3.9 DWP employer and individuals research finds that automatic enrolment is expected to increase levels of pension scheme membership. Almost seven in ten people eligible for automatic enrolment say they would stay in and save in a workplace pension if automatically enrolled tomorrow**.** [109] Research on the 401(k) experience in the United States shows among employers using automatic enrolment there is a large difference in participation rates between those hired before automatic enrolment (50 to 75 per cent) and after automatic enrolment (90 per cent or more). Similar research also shows that automatic enrolment had the greatest effect among people on low incomes, people from minority ethnic groups and women.[110]

Automatic re-enrolment

3.10 Individuals can choose to opt-out of pension saving. Saving in a pension will not be the right thing for every individual all of the time. Research finds that not all individuals will choose to remain in workplace pension saving following automatic enrolment: 22 per cent say they will opt-out.[111] Individuals will choose to opt-out if they do not consider it the right time for them to save in a workplace pension. This can be due a range of reasons for instance that individuals are already making sufficient provision for their retirement, or have other priorities, such as reducing debt.[112]For those individuals who choose not to save because it does not suit their personal circumstances, the opt-out process is designed to support the individual's decision not to save.[113]

3.11 Changes in income, employment and domestic arrangements may drive some individuals who have opted out to want to save at a later point.[114] Re-enrolment will help maximise savings and harness decision-making inertia by providing individuals with an opportunity to re-consider their savings decision. The number of individuals who are re-enrolled is likely to decline as reforms to workplace pension savings become embedded over time.

Opt- ins

3.12 The Government believes it is also important to provide an accessible pensions savings product for employees not eligible for auto-enrolment, self-employed people and for members of the personal accounts scheme who wish to continue to save during periods out of paid work, for example if they take a career break due to caring responsibilities.

3.13 Current pension participation is low among those eligible to opt-in to a qualifying workplace pension.

- Among those outside the automatic enrolment age bands and earning more than £5,035 per annum (in 06/07 terms), pension participation is around 10 per cent for those aged below 22; and 26 per cent for those above state pension age but under 75.[115]
- Among those earning less than £5,035 per annum (in 06/07 terms), who would not be eligible for an employer contribution under the reforms, around 8 per cent participate in pension savings. [116] These individuals will be required to make an active decision to participate in their employer's pension saving scheme.
- The self-employed can choose either existing schemes or the personal accounts scheme. The self-employed will not be able to benefit from an employer contribution. Around 34 per cent of those that are self -employed are currently contributing to a personal pension.[117]
- Inactive and unemployed individuals who have previously contributed to a personal account are eligible to opt-in to the scheme. Around 4 per cent of economically inactive people are currently contributing to a personal pension.[118]

3.14 **As a result of the reforms overall**, an estimated 10 to 11 million people will eligible for automatic enrolment into a workplace pension scheme. [119]After accounting for people who opt-out we expect this will result in:

- 5 to 9 million people newly saving or saving more in all forms of workplace pensions;
- 3 to 4 million people newly saving or saving more in existing forms of workplace pensions;
- 3 to 6 million people participating in the personal accounts scheme, including some who were previously saving in existing forms of workplace pension scheme, and some who opt-in.

Impact on amount of new saving

3.15 For individuals participating in workplace pension schemes and making the minimum contribution of 4 per cent, the aggregated annual pension contributions are estimated at £4.5 billion (2009/10 earnings terms) once contributions have been fully phased in. This is within a range of £3.2 billion to £5.1 billion.

3.16 Table 3.2 shows aggregate annual pension contributions from individuals participating in workplace pension schemes between 2020 and 2050. This is based on DWP modelling of the current UK pension landscape and assumes that

contributions increase in line with earnings growth over time. Of these amounts approximately 50 to 70 per cent are expected to represent additional household saving.[120]

3.17 Participation in a private pension scheme with a minimum employer contribution enables individuals to transfer income from their working life to their retirement. As a result, many individuals are likely to enjoy increased well-being over their lifetime through an economic concept known as 'consumption smoothing' as explained in Chapter 2.

Table 3.1: Total estimated individual contributions in future years (£ billion)

	2020	2030	2040	2050
Individual contributions	**5.1**	**6.2**	**7.6**	**9.3**

Source: DWP modelling.
Notes: Costs are expressed in 2009/10 prices and are rounded to the nearest £100 million

Income- related benefits

3.18 Some individuals may require more help from the state than others through benefits. An individual's contribution to a private pension scheme will have an impact on their income; half an individual's contribution to a private pension scheme is disregarded from their income when calculating entitlement to income-related benefits. This can increase benefit entitlement. DWP analysis suggests around 240,000 jobholders who are in receipt of an income related benefits (Income Support, Council Tax Benefit, Housing Benefit and Income-based Job Seekers Allowance) will be eligible for automatic enrolment.[121] Of these, around half are also in receipt of tax credits. Receipt of working- age benefit may therefore be an added incentive to save.

Tax credits

3.19 An individual's contribution to a private pension scheme is fully disregarded from their income when calculating entitlement to tax credits. People may become eligible for tax credits for the first time or entitled to increased tax credits as a result of contributions into a private pension scheme. Eligibility criteria for tax credits is complex[122] therefore, it is not possible to make precise estimates of the number of people who may be affected, or the average change in entitlement. For example, tax credit entitlement is based on the lower of the current and previous year's income which makes it difficult to assess the effect.

3.20 DWP analysis suggests that approximately 2.3 million family units are in receipt of tax credits and have at least one member eligible for automatic enrolment. Of these, around 30 per cent would see a small change to their tax credit entitlement.[123] We estimate entitled non-recipients and new claims for tax credits to remain low based on the size of the entitlement.

Box 3.1 Illustrative examples of the interaction of reform and tax credit

Peter and Jill live together. They have two children and have no childcare costs. Jill is aged 26 and works as a part-time volunteer at a small charity. Peter is aged 28 and works full-time for a water company and earns £20,000 a year. Peter starts to save into a private pension in 2012 when he is automatically enrolled into his workplace pension. He starts paying a 1 per cent contribution on qualifying earnings half way through the financial year (i.e. a contribution of £75). Peter and Jill's annual tax credit entitlement increases by around £30.

Fiona is single and has two children. Fiona is aged 28 and works full-time as a mechanic and earns £25,000 a year. She pays £200 a week in childcare costs. The company Fiona works for is small. She is therefore not automatically enrolled into a workplace pension until the end of staging. Fiona decides to start paying 3 per cent pension contribution into her workplace pension at the beginning of the financial year (i.e. a contribution of around £600 a year). Her tax credit entitlement will increase by about £230 a year. However, Fiona's tax credit award is based on her income in the previous year which was £22,000; therefore her tax credit entitlement will not be affected until the following year.

Raj is single, and has no children. Raj is aged 34 and works full-time writing articles for the local newspaper. He earns £10,500 a year. Raj starts paying 3 per cent pension contribution into his workplace pension at the beginning of a financial year (i.e. a contribution of around £165 a year). Raj's tax credit entitlement will increase by about £64 a year. Raj had earned more in the previous year, so his tax credit award is based on his current income of £10,500. Raj's tax credit entitlement will therefore be affected in the current year and he will see an increase.

Impact on Income during retirement

3.21 Analysis by the DWP[124] shows that the vast majority (over 95 per cent of individuals), get back more in retirement than they put in as contributions. Most get back more than twice what they put in even after taking into account inflation. The analysis is discussed in more detail in Box 3.2.

Box 3.2 Financial incentives to save

A work programme was undertaken by DWP in close collaboration with key stakeholders to analyse the financial incentives to save in a pension following reforms in the 2007 and 2008 Pension Acts. The programme undertook extensive analytical modelling of the impact of pension saving on net retirement income through a) case study information to help understand what will happen to typical people and households and b) analysis of the distribution of outcomes from saving across the population as a whole given reasonable assumptions about the future characteristics and future tax and benefit system.

Key findings of the analysis, given reasonable assumptions about the future and factoring in savings made into a defined contribution pension after 2012 with an employer contribution are summarised below:

- Virtually everyone modelled - over 99 per cent - is better off in retirement by saving. In other words they have more money available to them in retirement than if they hadn't saved;
- For the vast majority - over 95 per cent - the improvement is greater than the cost of contributions even after taking inflation into account;
- The large majority of savers get back more than twice what they put in, even after taking inflation into account; and
- There is no readily identifiable group in the working age population whose members would not, on average, gain back more than they put in to a pension.

These results focus on a particular interpretation of financial incentives to save: the amount people will gain in retirement from saving as a result of contributing to a pension during their working life and how this compares to the contributions they make. It is important to remember that this is just one of the factors that will influence individuals' decision and may not be the most important: smoothing one's income between work and retirement is generally considered to be the main aim of pension saving. This may make it worthwhile to save even in the absence of high expected returns.

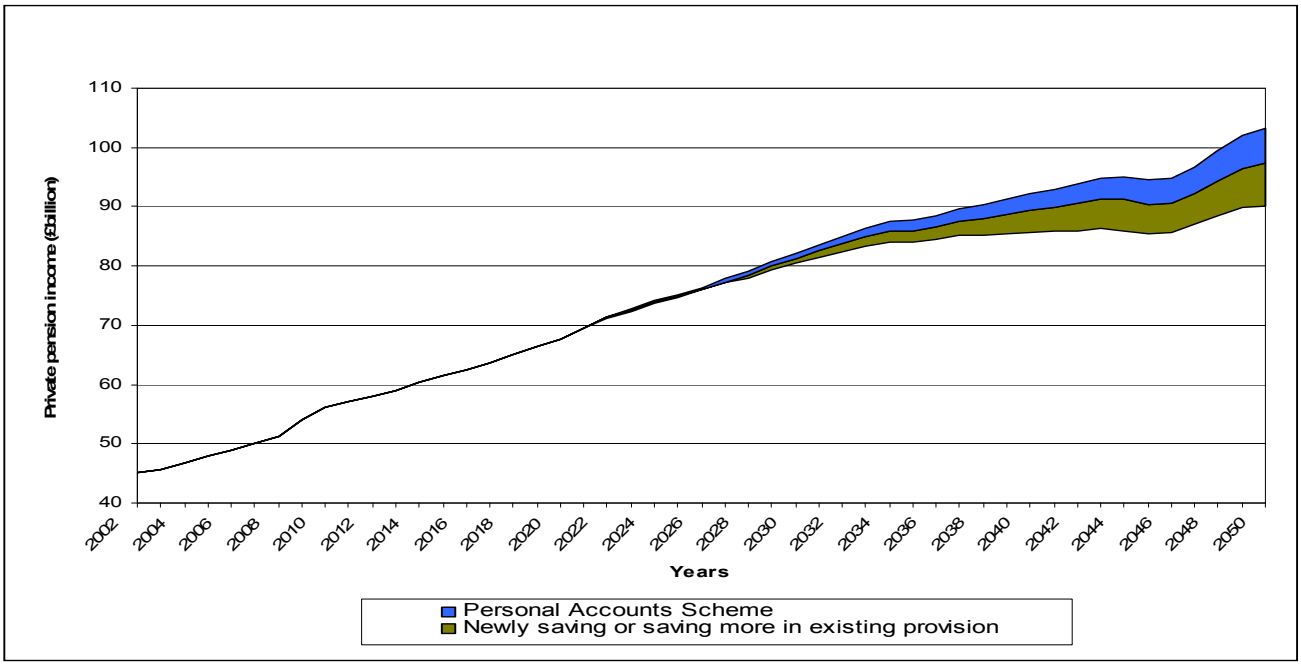
Source: Department of Work and Pensions (2009) Saving for retirement: Implications of pension reforms on financial incentives to save for retirement. DWP Research Report No. 558

Aggregate private pension incomes

3.22 Private pension incomes will increase as a result of the reform. In 2050 increases in private pension incomes are estimated at around £11 to14 billion a year (2009/10 prices), or £5 to 7 billion in 2009/10 earnings terms. The reforms could increase private pension income for pensioners aged between 68 and 75 in 2050 by over ten per cent. The projections are based on modelling the impact of pension reform on future retirement incomes using the DWP's Pensim2 model.[125]

3.23 Figure 3.2 illustrates the increase in private pension incomes in the principal scenario. Increases in the private pension income in later years are due to increases in State Pension age and increases in earnings.[126] The combination of these effects is particularly pronounced in the years 2034 and 2044.

Figure 3.2: Estimated change in total private pension income



Source: DWP modelling using the Pensim2 model.

Note: Figures are shown in 2009/10 prices.

State benefit system and Pension Credit

3.24 Similar to income-related benefits and tax credits discussed earlier, in retirement, any savings or income will be taken into account when calculating any benefit entitlement, so those with higher private income may have lower benefit entitlement. [127]The state benefit system provides a safety net, guaranteeing a minimum level of income for those unable to build up sufficient state entitlement or who need extra support such as the disabled or those with caring responsibilities. Most people will aspire to have more than the minimum provided by the state, while anyone who chooses to rely on income-related benefits is making assumptions about what the benefit system might look like 20, 30 or 40 years from now. Reforms in the Pensions Act 2007 mean that those who spend at least half of their life working or caring – including low earners – will be taken above the standard Pension Credit entitlement. In addition, the savings reward in Pension Credit and the lump sum and trivial commutation rules[128] mean that many of those who do end up with some income-related benefit entitlement may still see a benefit from saving and an increase in income that exceeds the value of their contributions.

Replacement rates

3.25 The Pensions Commission used the concept of a 'replacement rate' to measure adequate retirement income. Replacement rates refer to income that individuals enjoy in retirement as a proportion of their income in working life. Those individuals that have lower earnings over their lifetime will achieve higher replacement rates. This is because they receive higher state pensions as a proportion of their working age income. For this same reason, those on higher earnings will have a lower replacement rate. This is reasonable for two reasons noted by the Pensions Commission. Higher earners are more likely to have been saving for bequest motives

as well as to smooth consumption over their lifetime. Individuals on lower incomes may need higher replacement rates to be able to have a minimum acceptable standard of living at retirement.[129]

3.26 Table 3.1 shows the possible outcomes what, a set of illustrative individuals might expect from saving at the minimum contribution rate in terms of retirement incomes and replacement rates. The analysis is based on DWP modelling.

3.27 The model used to assess the impacts of pension policy changes on retirement incomes uses hypothetical individuals. They cannot be said to represent a particular person working today, as for any real individual their future history will be uncertain and so, even if their existing characteristics are identical to those modelled, their future is unlikely to be so. In particular, a real individual may have the opportunity to make choices to maximise their overall benefit. The model does not provide estimates of the likelihood of an outcome (although we use estimates from other sources to make assumptions on certain characteristics such as earnings). However, it shows clearly how a set of characteristics can lead to particular outcomes in retirement. The impact on individual replacement rates is explained in more detail using case studies in Box 3.3.[130]

3.28 Individuals and employers can choose to contribute more than the mandatory minimum contributions of 4 per cent on qualifying earnings for individuals, and 3 per cent for employers in steady state. DWP research shows that just under half (46 per cent) of those who said they would remain saving also said they would be likely to contribute above the minimum level of 4 per cent on a regular basis. Of these, more than half (54 per cent) said they would be likely to make contributions of 5 or 6 percent, around two in ten (21 per cent) said they might contribute between 7 and 9 percent, and a further two in ten (19 per cent) said they might contribute between 10 and 20 per cent.[131]

Box 3.3 Illustrative examples of replacement rates

Rosie is aged 30 and earns £25,000 per year working for a tax consultancy company. Rosie only starts to save into a private pension in 2012 when she is automatically enrolled into her workplace pension. Rosie makes the minimum contribution (5 per cent on qualifying earnings including tax relief) from 2012 until State Pension age. On average Rosie can expect a gross weekly private pension income of £55 in retirement. Her final net weekly income (including any benefit entitlement) in retirement is £221 equal to 47 per cent of her income during working life. If Rosie had not started saving for retirement her replacement rate would be 10 per cent lower.

Colin is aged 40 and earns £15,000 per year working for a part time for a local catering company. Colin only starts to save into a private pension in 2012 when he is automatically enrolled into his workplace pension. He makes the minimum contribution (5 per cent on qualifying earnings including tax relief) from 2012 until State Pension age. On average Colin can expect a gross weekly private pension income of £17 in retirement. His final net weekly income (including any benefit entitlement) in retirement is £ 185 equal to 64 per cent of her income during working life. If Colin had not started saving for retirement his replacement rate would be 4 per cent lower.

Table 3.2: Gross replacement rates and weekly retirement incomes for illustrative individuals

		Age in first year of saving under the reforms			
Annual earnings*		22	30	40	55
£10,000	Gross weekly private pension (£)	16	12	8	2
	Final net weekly Income (£)	192	185	175	168
	Replacement rate with saving (%)	100	96	91	88
	Improvement in replacement rate from saving**	7	5	2	1
£15,000	Gross weekly private pension (£)	34	27	17	4
	Final net weekly Income (£)	205	197	185	174
	Replacement rate with saving (%)	72	69	64	60
	Improvement in replacement rate from saving**	10	8	4	1
£20,000	Gross weekly private pension (£)	52	41	26	7
	Final net weekly Income (£)	219	209	197	182
	Replacement rate with saving (%)	59	56	51	47
	Improvement in replacement rate from saving**	11	9	5	1
£25,000	Gross weekly private pension (£)	71	55	34	9
	Final net weekly Income (£)	235	221	207	191
	Replacement rate with saving (%)	51	47	44	40
	Improvement in replacement rate from saving**	13	10	6	1
£30,000	Gross weekly private pension (£)	89	70	43	11
	Final net weekly Income (£)	252	234	216	201
	Replacement rate with saving (%)	46	42	39	35
	Improvement in replacement rate from saving**	14	10	6	2
£35,000	Gross weekly private pension (£)	107	84	52	13
	Final net weekly Income (£)	268	247	225	211
	Replacement rate with saving (%)	42	39	35	32
	Improvement in replacement rate from saving**	14	11	6	2

Source: DWP Modelling. These outcomes are not guaranteed and are dependent on investment performance.

Notes: * Annual earnings are expressed in 2009/10 earnings terms.

- The figures are based on the age of the individual in 2012 (22, 30, 40 and 55);

- The illustrative individuals are assumed to start work at age 25 (except for the first individual who starts work at age 22) and work up to State Pension age which is not necessarily the same for all the individuals in the table;
- They save from 2012 until State Pension age at the default rate with a charge equivalent to a reduction in yield of 0.5 per cent, with phasing of contributions over six years. It is assumed the fund is lifestyled and that the individual takes and annuitises the tax-free lump sum;
- Replacement rates are calculated using the formula: gross income including any benefit entitlements in the 1st year of retirement divided by gross earnings in the final year of work; and
- The figures include Council Tax Benefit entitlement with or without saving, with the full weekly liability assumed to be £16 in 2009
- Percentage point improvement in replacement rate from saving.

3.29 The Government recognises that individuals will need good information to help them decide whether to opt-out of saving and will use research with individuals and stakeholders to ensure that appropriate information is available.[132]

Short-term impact on individual saving

3.30 The objective of the reforms is to maximise individual saving while minimising burdens on employers and impacts on the pension industry. Certain regulations designed to improve the operational viability of the reforms or minimise burdens on employers can potentially reduce contributions to pension saving in the short-term. This will have an effect on retirement incomes that individuals will enjoy in the long-term. However, this negative impact needs to be set against an overall increase in pension saving as a result of the reforms.

Employer duty to maintain active membership

3.31 The regulations allow employers to have a one month gap between active membership in qualifying schemes when they are replacing one qualifying scheme with another. In an extreme scenario, a monthly gap in a jobholder's contributions eight times over their working life could lead to a reduction in total fund size of 2 per cent compared to an individual who experiences continuous contributions throughout their working life.[133]

Postponement periods

3.32 An employer with a higher quality scheme may postpone the automatic enrolment of a jobholder into that pension scheme for up to three months, provided they subsequently automatically enrol their employee into a workplace pension scheme and contribute at least 6 per cent of qualifying earnings for a minimum of three months following the postponement period. An employer may not use postponement for any individual for whom they have already postponed automatic enrolment within the previous year.

3.33 Employees working in sectors with high turnover rates are the most likely to be affected by postponement periods. This can affect younger employees, females, ethnic minorities and part-time workers the most as they are over represented in sectors which have high turnover rates. However, where employers take on staff on consecutive short-term contracts, they may not use postponement if the jobholder's

automatic enrolment date has already been postponed at any time during the previous 12 months.

Implementation regulations

3.34 It is not operationally viable to implement the reforms all at once. Although the reforms increase overall pension saving, the proposed staged approach to these reforms will mean that some eligible jobholders will not be automatically enrolled until late 2016.

3.35 Any staged approach to automatic enrolment and default contributions, when compared with a scenario where default contributions are immediate and in full, will have a slightly adverse effect on pension savings built up by savers that are automatically enrolled towards the end of the implementation period. For instance in a scenario were individuals are automatically enrolled in September 2016 they could have a pension fund 3 per cent lower than if the same individuals had been automatically enrolled in the first stage and became subject to the duties in October 2012.[134]

3.36 The adverse effect on pension saving may be proportionately greater for some individuals, for example older workers at the point of automatic enrolment and those with career breaks who will have less time to build up their savings under the reforms. This is because the contributions foregone represent a larger proportion of their potential savings.

Protecting individual savings

3.37 The Government's reforms to workplace pensions will introduce important new requirements for employers and rights for workers. The Pensions Regulator (TPR) will be responsible for building and operating an effective Employer Compliance Regime (ECR). TPR will operate this regime in line with the primary and secondary legislation. The risk-based flexible regime is designed to ensure rights are effectively safeguarded while imposing no unnecessary burdens on business. TPR will be able to take enforcement action such as issuing notices and penalties to maximise compliance.[135] Individuals who report their employers' breaches to TPR will be protected against being treated unfairly as a result

Chapter 4: Impact on Employers

Background

4.1 The Government's reform programme places employers at the heart of pension provision, and can only be successful with the support and involvement of employers.

4.2 Many employers in the UK are already making a substantial contribution to pension schemes and are supporting their workers to save for retirement. However, over the last few years employers' provision of workplace pensions has become less generous.

4.3 In order to meet the challenges identified by the Pensions Commission, employers who do not already contribute towards pensions will also need to play a role. The reforms will require employers to automatically enrol eligible jobholders, into and contribute, to a qualifying workplace pension scheme.

4.4 The Government's aim in developing these regulations has been to minimise the overall employer burden, whilst also ensuring that the needs of individuals to maximise saving for retirement are protected. DWP believes that the provisions set out in the regulations balance the needs of savers and the burdens on employers and schemes in the most effective way.

4.5 **The chapter covers four key areas:**

- Current pension provision by employers – just under half of employers provide a pension scheme and provision tends to be better amongst large employers
- Employer attitudes to workplace pension reform – the majority of employers support the reforms, though views are affected by current economic conditions
- The costs to employers of workplace pension reform. This includes the cost of additional contributions employers will make as a result of the reform and the cost of administering the reform; and.
- Regulations which are designed to minimise the burden of additional costs on employers.

Current pension provision by employers

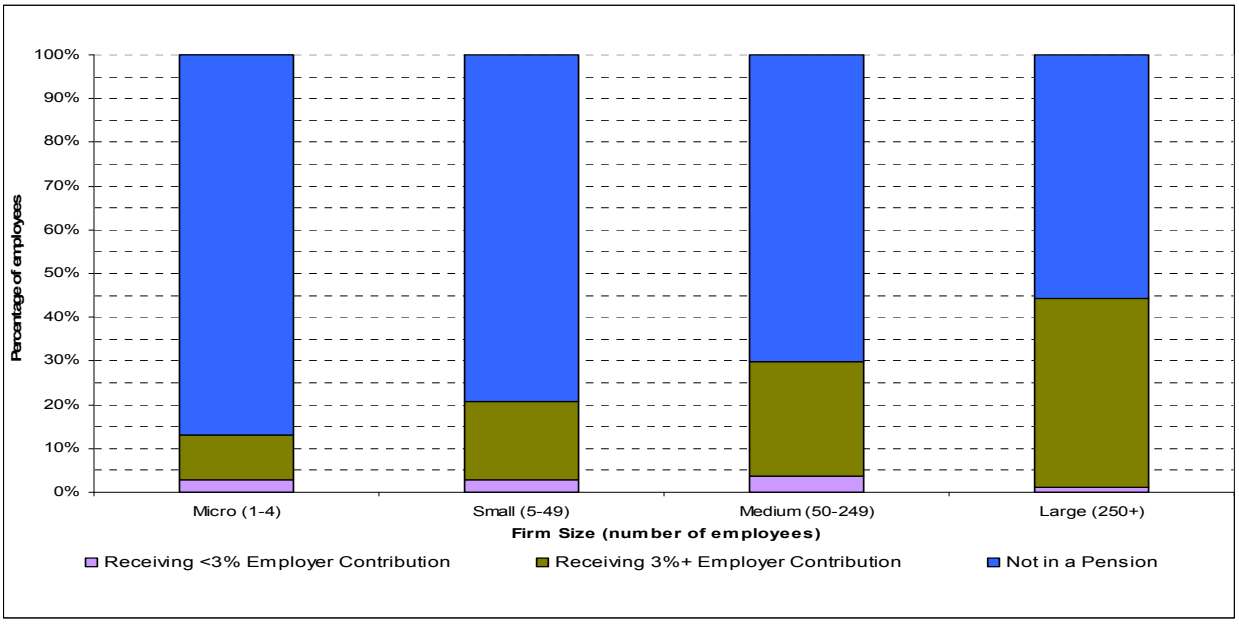
4.6 Analysis by DWP shows of the 1.3 million employers in the private and not-for-profit sectors:

- Approximately 750,000 employers offer no workplace pension provision[136];
- Approximately 280,000 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.[137]

4.7 Overall, workplace pension provision has increased since 2001 when legislation came into place requiring employers with five or more employees to provide employees with access to a Stakeholder Pension (SHP). But employees often do not participate in workplace pension schemes and even where they do the scheme does not always attract an employer contribution, especially in smaller firms. In 2008, of employers with less than 100 employees, 10 per cent of employees with group personal pensions (GPPs) and 29 per cent of those with SHPs received no employer contribution[138]

4.8 Employees working in large firms are more likely to be in a pension scheme and to be receiving relatively generous employer contributions compared with those working for small and medium-sized firms (Figure 4.1). Employees in larger firms are also more likely to receive a pension which attracts employer contributions of more than 3 per cent, which is the minimum they are required to contribute under the reforms.

Figure 4.1 Existing pension provision – scheme membership by firm size



Source: DWP analysis based on the Employers Pension Provision Survey 2007, Small and medium sized Enterprise (SME) statistics 2007 and the Annual Survey of Hours and Earnings 2007.

4.9 There are a number of reasons why some employers choose not to offer a pension. Among firms that do not currently provide pensions, 32 per cent said that their main reason for not doing so was that their organisation was too small. The next most common reasons given were that it was too costly (13 per cent), that staff did not want a pension (11 per cent) and that the firm had mainly part-time or temporary staff (6 per cent). One in three non-providers said that they were seriously considering introducing a pension scheme over the next five years.[139]

Choice of scheme

4.10 Currently, employers may choose to provide either a trust-based occupational pension scheme or a contract-based Workplace Personal Pension (WPP). A trust-based occupational scheme is set up by the employer and run by a board of trustees while a WPP is a scheme facilitated by the employer but with a contract between the pension provider and the individual.

4.11 Private sector occupational pension scheme membership, particularly in defined benefit (DB) schemes, has been in long-term decline since the 1960s. Membership in DB schemes within the private sector has fallen from 4.6 million in 2000 to 2.7 million in 2007, while membership of private sector defined contribution (DC) schemes has remained relatively constant over the same period. Private sector membership in contract based DC schemes has, however, grown from 0.2 million in 1997 to 2.6 million in 2008. This shift in popularity to contract- based schemes can be explained by employers' attitudes to these schemes which they see as less costly to run compared with occupational pension schemes.[140]

Employer attitudes to reform

4.12 Research shows that most employers are supportive of the reforms and that awareness and support is generally stronger amongst larger firms. Views expressed were more positive in the 2007 survey, than the 2009 survey - which is likely to reflect the prevailing economic circumstances. With economic recovery expected before 2012, employers may feel better able to support the reforms by the time the legislation comes into effect

4.13 Survey evidence collected in 2007 suggests that overall the majority of employers (58 per cent) across all firm sizes thought the reforms were a good idea, and 70 per cent of all employees worked for these employers.[141] Emerging evidence from 2009 suggests that 56 per cent of employers believe that these reforms are a good idea. Those giving the highest levels of support for reform included those already contributing 3 per cent or over towards pensions provision (77 per cent). However, 37 per cent believe that they are a bad idea.

4.14 DWP recently undertook qualitative research, specifically with small employers, to understand their likely response to the reforms under different economic scenarios: economic uncertainty; the beginning of an economic recovery and full recovery alongside details of the implementation.[142] This clearly showed that employers' ability to cope, and therefore attitudes to the reform, are very much linked to the economic situation of the time. More details of the research are set out in Annex A.

4.15 This research also showed a limited awareness of the reforms amongst small and medium-sized employers, as might be expected at this early stage of the reform process. [143] It also chimes with other research (a 2008 survey commissioned by PADA) that found a strong link between attitudes to pensions and size of businesses, with larger organisations more positive about pensions as a way to save for retirement and as a benefit to staff.

4.16 The Government will continue to monitor trends in pension provision, the economic context in which these reforms will be introduced and attitudes of employers to the reforms. The programme intends to fully evaluate the effects of the reforms against the policy objective of getting more people to save more for retirement. The evaluation will also assess the impacts of the reforms on employers, to evaluate the extent to which the policy objective is met whilst putting minimal burden on employers and maintaining current good pension provision.

Costs to Employers of Pension Regulations

4.17 The duties on employers to automatically enrol jobholders into qualifying workplace pension arrangements and make minimum contributions will lead to an increase in aggregate employer contribution and administrative costs. The pension regulations have been designed to minimise burdens on employers while ensuring that individual savings are protected and existing pension provision is maintained. This section sets out analysis and research showing:

- Estimated costs to employers of making minimum contributions required under the reforms to employees' pensions will be an estimated £ 3.4 billion (in 2009/10 prices) once reforms are fully implemented.

- Estimated costs to employers of administering the reforms will be an estimated £443 million in the first year and £130 million in future years (in 2009/10 prices).

- The implementation design means that employers, especially those that are staged in later, will face lower contribution costs during the implementation period.

4.18 The ability for employers to manage the cost of reform will vary across firms depending on their specific circumstances. The 2007 Employer Attitude Survey noted several ways of managing the additional costs of the reforms including: absorbing the increase through overheads (cited by 28 per cent), increasing prices (21 per cent), lowering wage increases (14 per cent), or restructuring their workforce (8 per cent). Smaller employers had similar responses in 2007. A number of employers (10 per cent) suggested they might encourage their employees to opt out[144]. As discussed in Chapter 1, the compliance regime will aim to mitigate this risk.

Contribution Costs

4.19 The reforms will require employers to contribute a minimum of 3 per cent of a band of qualifying earnings into their employees' pension. If employers were to make the minimum employer contribution for all eligible jobholders who do not opt-out, the value of additional employer contributions would be £3.4 billion[145] once contributions have been fully phased in. This is within a range of £2.5 billion to £3.9 billion, reflecting employer contribution costs for two groups of eligible jobholders: those that are newly enrolled into workplace pension schemes with a 3 per cent employer contribution (around 7.5 million individuals who do not opt-out); and those that receive an increase in contributions from their employer to 3 per cent where they are

currently receiving less than the minimum requirement (around 0.5m individuals). Table 4.1 below presents these estimates by firm size[146].

4.20 In the Pensions Bill - Impact Assessment (published April 2008), it was estimated that the minimum additional employer contributions would be approximately £2.5 billion[147] once contributions are fully phased in. These costs have since been updated to reflect latest evidence, specifically updated participation estimates and updated data on earnings.

Table 4.1 : Additional estimated costs to employers of minimum contributions, once contributions have been full phased in (£ million)

	Central estimate	Estimated range	Percentage of labour cost
Large firms	1,300	900 – 1,500	0.5%
Medium firms	600	400 – 700	0.7%
Small firms	1,100	800 – 1,200	0.9%
Micro firms	400	300 – 500	0.9%
Total costs	**3,400**	**2,500-3,900**	**0.6%**

Source: DWP modelling based on Employers' Pension Provision Survey 2007, SME statistics 2007, Annual Survey of Hours and Earnings 2008, DWP Research Reports 546 and 550.
Notes: Figures are expressed in 2009/10 earnings and prices and are rounded to the nearest £100 million. They may not sum due to rounding.

4.21 Box 4.1 gives some illustrative examples of the cost to employers of their contribution for different types of jobholders.

4.22 These costs can be expressed as a percentage increase in total labour costs as discussed in more detail in Chapter 2. [148] Table 4.1 shows that small and micro employers will face the largest relative increase in labour costs, as these firms are less likely to have existing pension provision.

4.23 Table 4.2 below shows what might happen to employer contribution costs over time if they increase in line with earnings growth. This implicitly assumes that the qualifying earnings band is up-rated in line with earnings growth. These estimates are used in the cost benefit analysis that appears in the summary.

Table 4.2: Total annual employer contributions in future years – central scenario (£ billion)

	2020	2030	2040	2050
Employer Contributions	**3.9**	**4.8**	**5.8**	**7.1**

Source: DWP modelling

Notes: Costs are expressed in 2009/10 price and are rounded to the nearest £100 million.

4.24 It is difficult to predict how employers will respond to the minimum contributions, and therefore the estimates above assume they contribute the minimum. However, some employers:

- May choose to contribute more than the minimum requirement, recognising contributions to a pension scheme as a useful recruitment and retention tool. Where employers choose to make contributions above the minimum level required, it can be assumed that these employers anticipate a benefit from the additional contributions that outweighs the costs of making them; whilst others
- May wish to offset part of the increased cost of contributions by reducing their current contribution rate.

4.25 Latest evidence on employer attitudes from 2009 suggests that 94 per cent of employers who are already making contributions of 3 per cent or more do not plan to reduce their contributions for their existing scheme members once the reforms are implemented, albeit around one in five said that they might reduce contributions for new employees[149].

Box 4.1 Illustrative examples of the contribution costs for different individuals

Example 1

Fiona is aged 27 and earns £37,000 per year working in a recruitment consultancy company. Fiona's employer will be required to automatically enrol her into a workplace pension and make a minimum contribution equal to at least 3% of her earnings between £5,035 and £33,540. This is 3% of £28,505 which equates to £855 per year or £71 per month. In the first transitional period, when Fiona's employer is required to pay 1% this would be £285 per year or £24 per month. In the second transitional period, when her employer is required to pay 2% this would be £570 per year or £48 per month.

Example 2

Peter is aged 42 and earns £13,000 per year working part-time for a charity. His employer will be required to automatically enrol him into a workplace pension and make a minimum contribution equal to at least 3% of his earnings between £5,035 and £33,540. This is 3% of £7,965 which equates to £239 per year or £20 per month. In the first transitional period, when Peter's employer is required to pay 1% this would be £80 per year or £7 per month. In the second transitional period, when his employer is required to pay 2% this would be £160 per year or £13 per month.

Example 3

Julie is 59 and works for a publishing house where she earns £45,000 per year. Julie is already a member of her employers qualifying workplace pension scheme and her total pension contribution is above 8%, of which 3% is from her employer. As Julie is already an active member of her employer's qualifying workplace pension scheme and receives the minimum employer contribution, Julie can remain in the scheme and her employer is not required to automatically enrol her into another scheme or make any extra contributions.

Administrative costs

4.26 This Impact Assessment presents the latest estimates of the administrative costs to employers of complying with the pension regulations. This brings together the costs estimated for the two consultations on draft regulations[150] on a consistent basis.

4.27 The fundamental concept and unit of measurement is a normally efficient business. In estimating these costs for Impact Assessment purposes, it is therefore assumed that all employers comply with the regulations. Any additional costs incurred by employers as a result of non-compliance or failure to comply with the duties have not been included. [151]

Administrative processes

4.28 Our estimate of the employer administrative costs takes into account the range of processes and functions that employers will need to perform to fulfil their legal obligations. These can be categorised into four discrete processes**:**

Process 1: preparing for start-up which includes:

- Investigating whether existing schemes meet the quality criteria;
- Decision makers meeting to discuss changes to business strategy due to the reforms;
- Making an arrangement with a pension scheme so that employees can be enrolled from the automatic enrolment date;
- Adapting or purchasing in-house or internal payment systems;
- Training staff to carry out the administrative processes; and
- Communicating with all employees about the firm's response to the reforms.

Process 2: registration which includes:

- Receiving written confirmation from the Pensions Regulator about the firm's automatic enrolment date twelve and three months before that date;
- Registering for the PAYE service with the Government Gateway if payroll is outsourced;
- Registering with the Pensions Regulator each PAYE scheme, giving details of the pension scheme(s) used to comply with the duties; and
- Re-registering once every three years, verifying the details of the pension scheme(s) being used.

Process 3: enrolment activity which includes:

- Providing information to existing members of qualifying schemes;
- Providing information to jobholders whose automatic enrolment is being postponed;

  - Enrolling eligible jobholders, providing them with the required information and providing their details to the pension scheme;
- Dealing with opt-outs and refunding any contributions deducted by the employer before the opt-out form was received; and
- Providing information to jobholders not eligible for automatic enrolment and workers without qualifying earnings about their right to opt-in to pensions saving.

Process 4: collection and administration which includes:

- The calculation and collection of contributions from employees pay with effect from day one;
- Payment of contributions to the pension scheme;
- Dealing with queries about deductions; and
- Processing requests to cease pension saving.

4.29 The regulations do not require employers to seek external advice on how to implement the reforms. This cost has not therefore been included in the administrative cost estimates. We will be seeking to minimise the need for external advice:

- The Government will provide employers with information and support before and during the implementation of the reform as discussed in Chapter 1.
- The delivery bodies will also help and support employers during the implementation of the reforms. The Pensions Regulator is planning to write to each employer 12 months and 3 months before the reforms are introduced, outlining their duties.
- The administrative processes of the personal accounts scheme will be tested with employers who join voluntarily in advance of the introduction of the reforms. This will help to minimise burdens and smooth out the processes for employers.

4.30 Nevertheless, employers may choose to seek advice from external bodies on how to implement the reforms – and it can be assumed that these employers anticipate a benefit from this advice that outweighs the costs. In 2008, 84 per cent of employers said that they are likely to seek advice. Smaller firms are more likely to consult external accountants (66 per cent), whereas larger firms are more likely to consult pension consultants, lawyers/legal advisors or actuaries.[152]

Administrative cost estimates

4.31 Each of the processes involves a number of tasks which the firm will need to carry out. The cost of each will depend on:

  - The time taken to carry out the task;
  - The person carrying out the task and their effective wage per hour, or the cost of outsourcing the task to a specialist organisation; and
  - The number of eligible workers in the firm.

4.32 Table 4.3 shows our updated estimates of total administrative costs to all firms, whether they automatically enrol jobholders into the personal accounts scheme or use an alternative qualifying scheme. The overall costs are lower for large firms, even though costs per firm are higher as there are fewer large firms (around 7,000 compared with 804,000 micro firms)

4.33 More detail about the changes to the cost estimates from previous Impact Assessments can be found in Annex G. Table 4.4 shows a breakdown of the total costs shown in Table 4.3 into lower level processes as described in 4.29 above.

Admin burden estimates

4.34 The ongoing annual administrative burden of these regulations is estimated to be £99 million. The administrative burden is a subset of the administrative costs and only includes those parts of the process which impose an information obligation on business. An information obligation is a regulation that requires a business to provide and submit information to the Government or to third parties such as employees and pension schemes.

Table 4.3: Employer administrative cost, by firm size (£ million)[153]

	Year 1 cost	Ongoing cost in future years†
Large firms	82	13
Medium firms	50	10
Small firms	138	41
Micro Firms	173	66
Total Costs	**443**	**130**

Source: DWP modelling.
Notes: Figures are expressed in 2009/10 earnings and prices and may not sum due to rounding. Cost in year 1 include one-off costs and the ongoing costs for that year. † Costs of re-enrolment and re-registration which only occur once every three years have been divided by three.

4.35 Compared with the Pensions Bill Impact Assessment published in April 2008, the latest estimates of the year one costs and the ongoing annual costs have both increased. This reflects improvements in how the costs have been modelled based on a better understanding of the detailed processes that employers will be required to complete rather than additional requirements as a result of changing policy. The most significant changes result from:

- More detailed understanding of the automatic enrolment process, including the process for opting-out;
- More robust estimates of the number of individuals eligible for automatic enrolment and where they are likely to be enrolled;

- More robust estimates of the number of individuals who, though not eligible for automatic enrolment, are required to be provided with some information and may opt–in; and

- Updated wage estimates from the Annual Survey of Hours and Earnings 2008.

Table 4.4: Employer administrative cost by process in year 1 and ongoing years

	Year 1 Cost (£m)	Ongoing Annual Cost (£m)
Process 1: Prepare for start-up	**£239.9**	**£10.1**
Investigating whether existing schemes meet the quality criteria.	15.2	-
Decision makers meeting to discuss changes to business strategy due to the reforms.	21.4	-
Making an arrangement with a pension scheme so that employees can be enrolled from the automatic enrolment date.	19.2	1.9
Adapting or purchasing in-house or internal payment systems.	45.7	-
Training staff to carry out the administrative processes.	83.2	8.2
Communicating with all employees about the firm's response to the reforms.	55.2	-
Process 2: Registration	**£16.4m**	**£2.4m**
Receiving written confirmation from the Pensions Regulator about the firm's automatic enrolment date (twelve and three months before that date at implementation.	5.3	0.3
Registering for the PAYE service with the Government Gateway if payroll is outsourced.	2.9	-
Registering with the Pensions Regulator each PAYE scheme giving details of the pension scheme(s) used to comply with the duties.	8.2	0.8
Re-registering once every three years, verifying the details of the pension scheme(s) being used.	-	1.4
Process 3: Enrolment activity	**£90.4**	**£21.2**
Providing information to existing members of qualifying schemes.	14.8	-
Providing information to jobholders whose automatic enrolment is being postponed.	1.0	0.2
Providing information to jobholders not eligible for automatic enrolment and workers without qualifying earnings about their right to opt-in to pension saving.	10.45	1.9
Enrolling eligible jobholders, providing them with the required information and providing their details to the pension scheme.	50.2	10.8
Dealing with opt-outs and refunding any contributions deducted by the employer before the opt-out form was received.	14.1	2.9
Automatic re-enrolment, including opt-outs and refunds.	-	5.4
Process 4: Collection and Administration	**£96.3**	**£96.3**
The calculation and collection of contributions from employees pay.	69.5	69.5
Payment of contributions to the pension scheme.	24.2	24.2

Dealing with queries about deductions and processing requests to cease pension saving.	2.5	2.5

Understanding costs better: choice of scheme

4.36 The administrative cost to employers estimated above will also depend on the way they choose to fulfil the new duties. This could be via an existing qualifying scheme or a new one, which could include the personal accounts scheme.

4.37 Within the aggregate figures presented above, we estimate that those employers who choose to fulfil their new duties by amending the rules of their existing scheme will have lower administrative costs than those setting up a new qualifying scheme. This is because the majority of employers setting up a new scheme will not benefit from having pre-existing systems and experience of dealing with pension contributions. The majority of those setting up a new scheme, over 1 million firms, are expected to use the personal accounts scheme. Based on responses to the Employer Decision Making (EDM)[154] research, it is expected that between 40 and 55 per cent of all those newly enrolled into a workplace pension will be enrolled into the personal accounts scheme. This is reflected in the participation estimates discussed in Annex F.

4.38 Before an existing occupational scheme can be used for automatic enrolment, the trustees and the sponsoring employer will need to review the current scheme rules to determine whether the qualifying criteria are met. Trustees will have a power to enable them to change scheme rules to allow for automatic enrolment. If the scheme meets the qualifying criteria the employer can then automatically enrol their eligible jobholders into the existing scheme. If not, then the trustees and the employer will need to agree to change the rules of the scheme or to automatically enrol their eligible jobholders into an alternative qualifying scheme.

4.39 DWP has estimated the cost of reviewing the rules and making the required changes to all open occupation schemes to be £70 million in the run up to the reforms. This is approximately £21 per scheme member.

Understanding costs better: size of firms

4.40 Table 4.5 shows the number of firms of each size and an average cost per firm of these regulations. This demonstrates that the average cost per firm is greatest for largest firms and lowest for micro firms. These per firm costs are dependent on the number of employees and by definition large employers have at least two hundred and fifty employees while micro employers have fewer than five employees.

Table 4.5: Average administrative cost per firm, by firm size			
	Number of firms	Cost in Year 1 (£)	Ongoing cost in future years (£)
Large firms	7,000	12,000	1,900
Medium firms	28,000	1,800	400
Small firms	386,000	400	100
Micro firms	804,000	200	100
All firms	**1,224,000***	**400†**	**100†**

Source: DWP modelling.
Notes: Figures are expressed in 2009/10 earnings and prices; Figures less than £100 are rounded to the nearest £10, £5, or £1 as appropriate and may not sum due to rounding.
* total number of projected firms in 2012; † average administrative cost.

4.41 Table 4.6 shows that the average administrative cost per employee is estimated to be lowest for larger firms and highest for micro firms. This reflects the fact that small firms are more likely to have to set up a new scheme and on average have lower participation rates in existing schemes and so will need to enrol a larger proportion of their workforce into a pension scheme. Larger firms are also able to spread the fixed costs associated with these regulations across a greater number of employees, as well as benefiting from economies of scale.

Table 4.6: Average administrative cost per employee, by firm size			
	Number of automatic enrolments	Cost in Year 1 (£)	Ongoing cost in future years (£)
Large firms	4,379,000	20	3
Medium firms	1,784,000	30	6
Small firms	3,257,000	50	15
Micro firms	1,518,000	130	50
All firms	**10,939,000***	**40†**	**15†**

Source: DWP modelling.
Notes: Figures are expressed in 2009/10 earnings and prices; Figures less than £100 are rounded to the nearest £10, £5, or £1 as appropriate and may not may not sum due to rounding.
* total number of employees; + average administrative cost.

4.42 The estimated costs of these regulations appear to affect small and micro firms the most (Table 4.3). It appears this way because there are so many more small and micro firms compared with large and medium employers. Small firms have a lower number of employees over which to spread the fixed costs of a pension scheme and are less likely to have existing pension arrangements in place. Box 4.2 gives illustrative examples of administrative costs for individual firms.

Box 4.2 Illustrative examples of the administrative costs to firms

Example 1
A large firm with two PAYE schemes employs 500 individuals in total, all of whom are over 22 and have qualifying earnings. Two hundred of the employees are already members of the firm's qualifying pension scheme and the employer will be required to notify them as such. The remaining 300 individuals will have to be automatically enrolled into a qualifying workplace pension scheme, and in this example we assume that around a quarter decide to opt-out of pension saving. If the employer opts to set up a new scheme for these individuals then the estimated first year cost of administering the reforms will be £6,600. If the employer elects to automatically enrol the remaining individuals into their existing qualifying scheme then the first year cost is estimated to be £5,600. Assuming the 225 individuals who decide to stay in the pension scheme have average qualifying earnings of £15,000, the steady state employer contributions (at 3%) would be £101,250 per year.

Example 2
A medium-sized firm with one PAYE scheme employs 100 individuals in total, all of whom are over 22 and have qualifying earnings. Fifty of the employees are already members of the firm's qualifying pension scheme and the employer will be required to notify them as such. The remaining 50 individuals will have to be automatically enrolled into a qualifying workplace pension scheme, and in this example we assume that around a quarter decide to opt out of pension saving. If the employer opts to set up a new scheme for these individuals then the estimated first year cost will be £2,600. If the employer elects to automatically enrol the remaining individuals into their existing qualifying scheme then the first year cost is estimated to be £2,000. Assuming the 35 individuals who decide to stay in the pension scheme have average qualifying earnings of £15,000, the steady state employer contributions (at 3%) would be £11,250 per year.

Example 3
A small firm with one PAYE scheme employs 20 individuals in total, all of whom are over 22 and have qualifying earnings. The firm offers a stakeholder pension with no employer contribution, but none of the employees have elected to join. All 20 individuals will have to be automatically enrolled into a qualifying workplace pension scheme, and in this example we assume that around a quarter decide to opt-out of pension saving. The employer is assumed to set up a new scheme for these individuals and the first year cost is estimated to be £700. Assuming the 15 individuals who decide to stay in the pension scheme have average qualifying earnings of £15,000, the steady state employer contributions (at 3%) would be £6,750 per year.

Example 4
A micro firm with one PAYE scheme employs 4 individuals in total, all of whom are over 22 and have qualifying earnings. The firm currently offers no pension. All 4 individuals will have to be automatically enrolled into a qualifying workplace pension scheme, and in this example we assume that around a quarter decide to opt out of pension saving. The employer is assumed to set up a new scheme for these individuals and the first year administrative cost is estimated to be £400. Assuming the 3 individuals who decide to stay in the pension scheme have average qualifying earnings of £15,000, the steady state employer contributions (at 3%) would be £1,350 per year.

Regulations to minimise burdens on employers

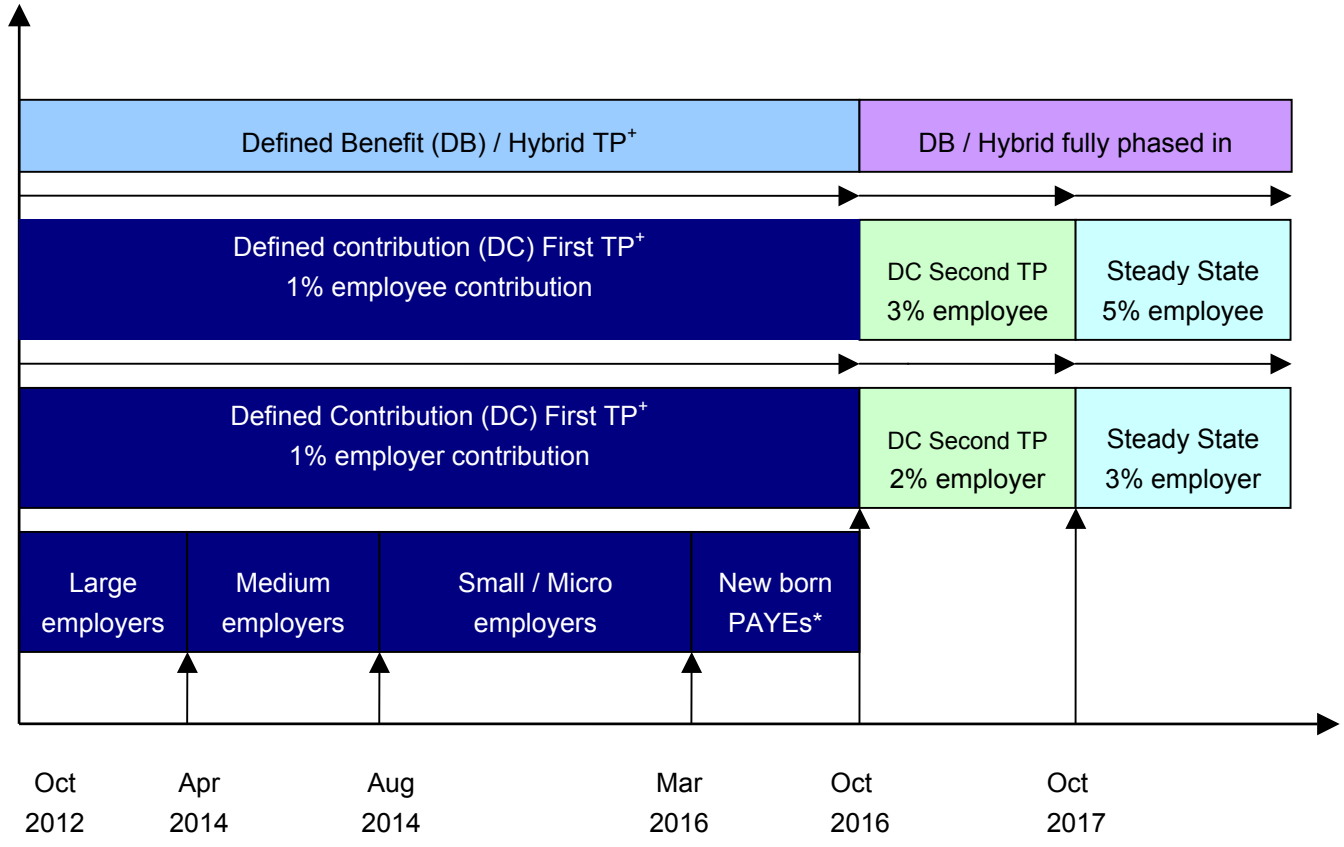
4.43 The regulations contain a number of measures to help employers adjust to the new requirements being placed on them:

- A commitment to phasing in both employer and jobholder contributions;
- Straightforward qualifying tests for existing schemes;
- Allowing employers offering higher contribution schemes to operate postponement periods; and
- A proportionate but effective compliance regime.

Implementation design

4.44 The workplace pension reform duties set out in the Pensions Act 2008 are due to come into force from October 2012. The key elements of the implementation design are shown in Figure 4.2.

Figure 4.2 Staged approach and DB and DC transitional arrangements



4.45 The key elements are that:

- Employers are staged in by size - from largest to smallest

- Employers will be able to phase in their contributions under the transitional arrangements specified in the Pensions Act 2008. The length of the transitional periods is prescribed in the Employers' Duties (Implementation) Regulations. For DC schemes, this simply means that employers will not pay the full contribution immediately; instead, employers will pay 1 per cent of the jobholder's qualifying earnings until October 2016 followed by a year at 2 per cent, before moving to 3 per cent in October 2017.

- There are transitional arrangements for those employers using DB and hybrid schemes[155]. Employers offering such schemes will be able to delay automatic enrolment until October 2016 for those jobholders who have previously chosen to opt-out.
- A small test group of randomly selected small and micro employers will be brought into duties ahead of other similar sized firms. This is to enable the delivery bodies to understand the responses of small and micro employers, and to adjust their communications and the compliance regime to best meet their needs.

4.46 Table 4.7 illustrates the combined impact of a staged approach and transitional arrangements on the contribution costs employers face under the duties. The latest estimate of minimum employer contributions is £3.4 billion once the reforms have been fully phased in. Employers will have to pay less in contributions during the implementation approach than they will in steady state.

4.47 Small and micro firms in particular benefit from this approach as they are brought under the duties later on in the process and have lower contribution costs over the implementation period as a result.

Table 4.7: Illustrated impact of staged implementation and DC transitional arrangements on contribution costs, by firm size (£ millions)

	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Large firms (250 or more employees)	20	300	440	440	660	1090	1310
Medium firms (50-249 employees)	0	0	170	200	310	510	610
Small firms (5-49 employees)	0	0	20	150	520	900	1080
Micro firms (1-4 employees)	0	0	10	50	200	360	430
Total costs	**20**	**300**	**630**	**840**	**1680**	**2860**	**3430**

Source: DWP modelling.
Notes: Figures are expressed in 2009/10 earnings and prices; Figures are rounded to the nearest £10 million and may not sum due to rounding.

4.48 A staged approach can affect the ability of employers to compete with each other in the short-term as some employers will face the cost of administering the reforms and contributing to their employees' pensions sooner than employers staged later. The extent to which implementation affects employers' ability to compete will depend on:

- ***How employers choose to cope with the reforms:*** For instance, if employers cope with the cost of the reforms by increasing prices then they will experience a price differential from competitors who are staged in later. Research on how employers may cope with the reforms is discussed in 4.17 and 4.18 above.

- ***Level of competition between firms staged at different times*****:** It is difficult to estimate the difference in staging time between employers that actively compete with each other. The level of competition between **employers of the same size** is likely to be stronger when they dominate certain sectors such as construction, when the level of demand in a particular geographical area imposes a practical limit on the size of the firm. Between **employers of different sizes,** large firms will potentially be disadvantaged by the staged approach, as they bear the costs of administering the reform sooner than smaller firms who will be staged in later. However, as shown in Figure 4.1 employees working in large firms are more likely to be in pension schemes already, and receiving relatively generous employer contributions, compared with those working for smaller sized firms.

4.49 Table 4.8 shows the estimated average additional contribution costs per firm during the staging period for different firm sizes. It can be used to quantify the competition impact between firms. The longer the difference in staging between firms that actively compete with each other, the greater the difference in the contribution costs they face. For instance, a large firm staged in 12 months before another large firm that it actively competes with will face approximately £64,000 more in contribution costs than the firm that is staged later.[156]

Table 4.8: Estimated average additional contribution costs by firm size during the staging period

	Average additional contribution costs by firm size (£ monthly)
Large firms (250 + employees)	5,340
Medium firms (50-249 employees)	615
Small firms (5-49 employees)	80
Micro firms (1-4 employers)	15

Source: DWP modelling.
Notes: Figures are expressed in 2009/10 earnings and prices and are rounded to the nearest £5.

4.50 The phasing of employer contributions moderates the potential impact on competition. All employers pay 1 per cent contributions during the first transitional period. Gradually introducing contributions in this way limits the potential impact that the implementation profile can have on competition between employers. If employers

moved to a different level of contribution before all employers had been staged in, the difference in contribution costs between employers staged later compared with those staged in earlier would increase.

Quality requirements for qualifying schemes

4.51 The quality requirements for qualifying schemes have been designed to enable employers to use a range of qualifying schemes to meet their duties, including existing provision.[157] The requirements for DC schemes should assist employers who wish to continue using their existing scheme and provide a straightforward test for those employers providing pension provision for the first time.

4.52 Employers can determine whether their DB scheme meets quality requirements in straightforward cases, whereas an actuary (by making projections and assumptions about earnings growth and other related factors) would be likely to make the determination in more complex cases. The costs are included in the estimates presented in Table 4.3.

4.53 Allowing non-UK schemes to be used by employers to fulfil their duties helps to minimise burdens on employers by encouraging them to maintain existing non-UK based provision in relation to jobholders who are already members of a non-UK scheme when the reforms are implemented.

Postponement periods

4.54 The regulations describing when employers are able to use postponement periods are discussed in Annex 1. Employers that choose to use postponement periods will save costs:

- Contribution costs associated with enrolling employees into the pension scheme when employees leave in the first three months;
- Some contribution costs when employees leave in the first six months; and
- Even where employees remain for the duration of the first six months, employers are able to defer administrative costs and each of the first three month's contributions which should improve cash flow.

4.55 Research with employers on the detail of these regulations found that most employers already offering high quality pension provision thought that the postponement option was a good idea and most expressed a desire to take advantage of it.[158]

Compliance regime

4.56 The compliance regime aims to ensure a level playing field. It is important for firms to know that contributions are expected from their competitors. For employers who do not comply, there will be a proportionate, risk-based compliance regime in place. This regime complies with Hampton principles and will focus on supporting and enabling employers to comply, but also allows necessary enforcement action to be taken. [159]

Chapter 5: Impact on Pension Industry

Background

5.1. The UK has a mature and extensive pensions market but it does not work well for low and moderate earners or those working for small firms.

5.2. Demand for pension products is low for reasons discussed in Chapter 1 and Chapter 3. Low demand for pension products affects how the pension market works. As individuals are reluctant to engage in pension saving, pension providers have to actively persuade people of the need to save on an individual basis, often through intermediaries. The complexity of pension products means that individuals find it difficult to make well-informed choices leaving them in a vulnerable position. Together, these issues make selling a pension expensive for providers. This problem is exacerbated when employers are small because providers are unable to spread costs across a large number of employees. The Pensions Commission estimated that the cost of setting up a pension scheme will generally exceed the returns to providers when dealing with firms of 20 employees or fewer.[160]

5.3. The nature of demand for pension products means there is less pressure on suppliers to reduce prices or improve services. This is because of particular features of pension products which mean that they cannot be experienced immediately or frequently (see Box 5.1).

Box 5.1 Demand side pressures in the pensions market

In markets where competition takes place, providers of services that deliver a better performance in terms of price and quality win a greater share of customers. This process is known as market competition and is driven by demand side pressure. This benefits consumers because it puts pressure on providers of services to produce higher quality products and to reduce prices.

In the pensions market the demand side pressure for pension products is weak. Therefore, there is less pressure on suppliers to reduce prices or improve their services. This can be attributed to the complexity of pension products. However, not all complex products are associated with weak demand. For example, automobile or mobile phone contracts are complex products yet their markets exhibit strong downward consumer pressure on prices. The reason pension products in particular are associated with weak demand is that (Unlike automobile or telephones), pension products cannot be experienced immediately or frequently. Where there is consumer power through regular repeat purchasing, customers dissatisfied with product quality or value for money can quickly switch to another brand. However, individual consumers of pensions cannot gain experience of the product in this way.

Source: Sandler Report, 2002. Available at: http://www.hm-treasury.gov.uk/

5.4. **This chapter covers four key areas:**

- The current pension landscape, including trends in membership in pension schemes, rates of employer contributions to pension saving and charge levels.

- Demand for pension provision post-reform
- Supply of pension provision post-reform, both from existing pension providers and the personal accounts scheme.

- The impact of workplace pension reforms on the pensions market in terms of the range of pension products available to customers and the price they pay.

Current Pensions Landscape

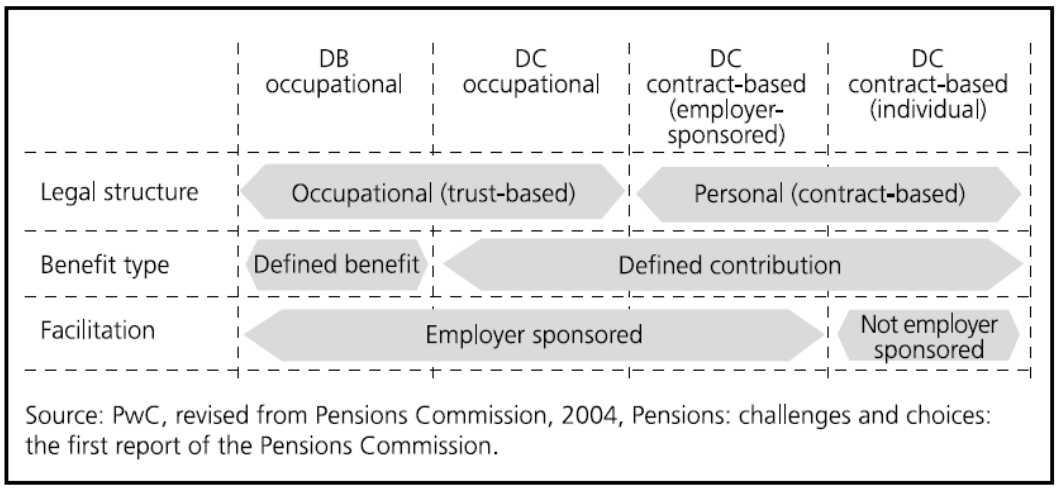
Background

5.5. Pension provision is currently voluntary and employers mostly offer either an occupational or workplace pension.

- Occupational pension schemes are set up by the employer and run by a board of trustees. Occupational schemes can be either defined benefit (DB) or defined contribution (DC) schemes or a hybrid of the two.
- Workplace Personal Pensions (WPPs) are facilitated by the employer but the pension itself is a contract between the individual and the pension scheme. WPPs can only be DC, but come in three common types: Group Personal Pensions (GPPs), Group Stakeholder Pensions (SHPs) and Group Self-invested Personal Pensions (Group SIPPs).

5.6. Figure 5.1 shows categories of private pension according to their legal status, type of benefit and whether they are facilitated by employers or not. The pension reforms under discussion are concerned with employer sponsored provision.

Figure 5.1: Categories of private pension



Source: PwC, revised from Pensions Commission, 2004, Pensions: challenges and choices: the first report of the Pensions Commission.

5.7. Pension provision in the UK is facilitated by three types of financial organisations:

- Employers can rely on different sources of advice, such as **Independent Financial Advisers (IFAs) or employee benefit consultants** to choose the most appropriate pension provider and pension scheme[161].

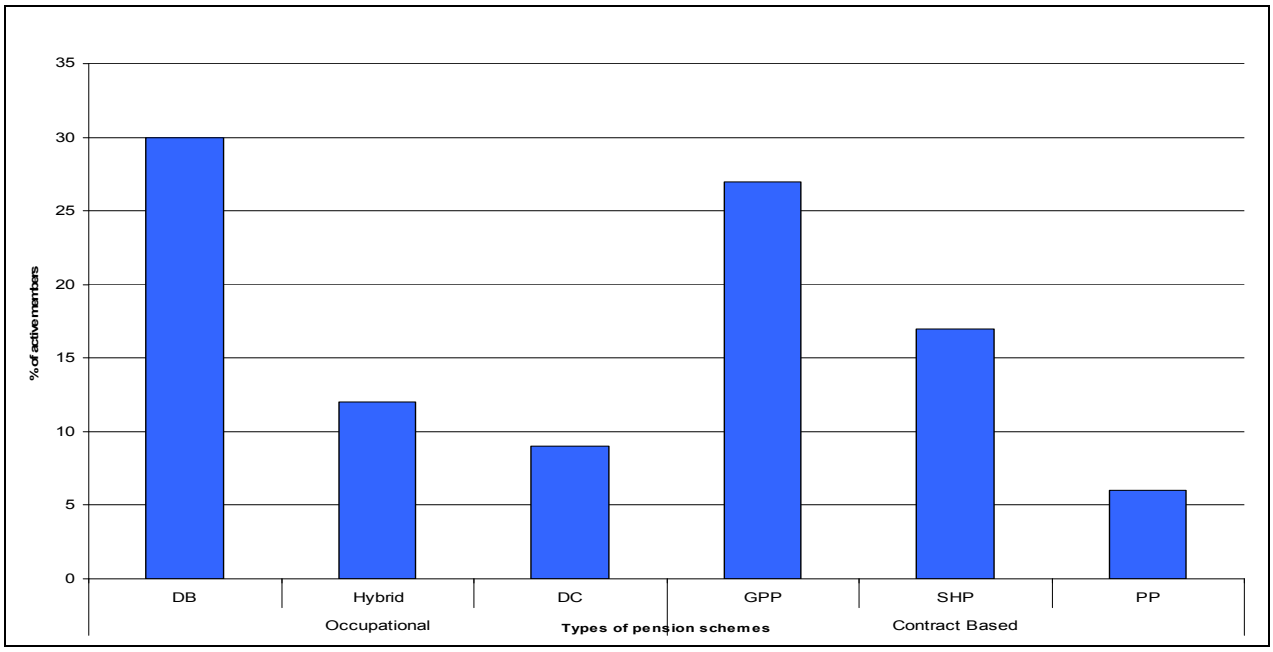
- **Pension providers** design, set up and administer pension schemes on behalf of the members in the case of Workplace Personal Pensions, or on behalf of the board of trustees in the case of occupational schemes.

- DC pension schemes offer members a number of funds in which to invest. **Fund managers** are responsible for making and implementing investment decisions on behalf of members.

Membership

5.8. Scheme membership is determined by the extent to which employers offer access to pension schemes and the degree to which employees select the schemes offered. Of active members in the private sector in 2007 (Figure 5.2), around 30 per cent were saving in a DB scheme and more than half (51 per cent) were saving in a trust based occupational DB, DC or hybrid scheme. Around 50 per cent were saving in a contract based DC scheme (GPP, PP or SHP).[162]

Figure 5.2 Membership in private pension scheme

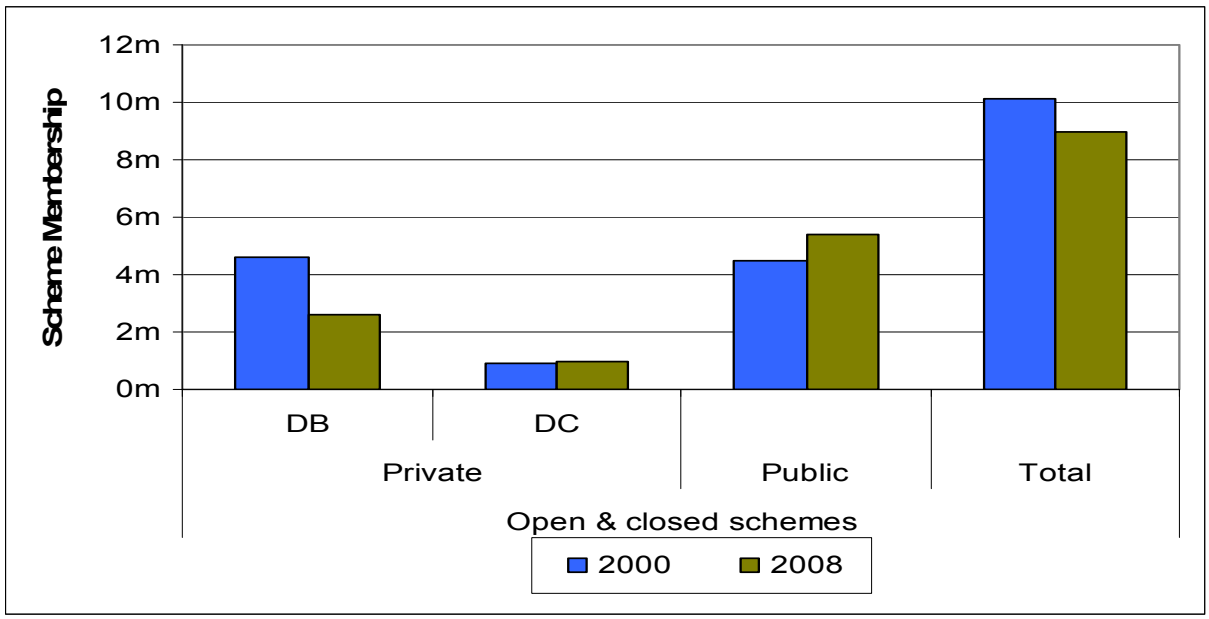


Source: EPP 2007

5.9. A couple of trends are apparent:

- **Membership of employer-sponsored DB schemes is in long-term decline and this trend is only partially offset by rising DC scheme membership**. This trend has accelerated in recent years. There is no one data source which gives a definitive picture of the latest developments. This trend can be illustrated in the shift in membership from DC to DB schemes shown in the Occupational Pension Scheme Survey (OPSS) - shown in Figure 5.3. The schemes referred to are those still accepting contributions from members (both open and closed schemes and schemes closed to new members) and all public sector schemes are defined benefit schemes.

Figure 5.3 Decreasing scheme membership in trust based occupational provision



Source: OPSS, 2000, 2008

- **Contract based schemes are replacing occupational schemes**. Employers tend to prefer contract-based pensions schemes because they are typically less costly, have less administrative burden and imply less responsibility for the employer.[163] Most employer sponsored DC membership is contract-based (60 percent) rather than occupational (40 percent).[164]

Contributions

5.10. Currently, employers can select the level of contribution they pay. Average employer contributions to DC schemes are lower than for DB schemes - the Occupational Pension Schemes 2008 Annual Report[165] reports average contribution rates of over 20 per cent of employees' salaries in DB schemes compared to 9 per cent in DC schemes. However, a direct comparison between DB and DC contribution rates is difficult - because DB contribution rates can be different from the value of pension rights being accrued and from the rates required to fund the pension promise over the long-term.

5.11. Declining employer contributions has been partly offset by an increase in contributions by employees to both employer sponsored pension schemes and personal pension schemes.

Charge levels and provider profitability

5.12. The level of charges paid by members affects the level of pension saving they enjoy in retirement. At present, charges in workplace pensions vary widely depending on characteristics of the employer, employees and features of the scheme or scheme type, but are generally lower than or equal to the stakeholder charging cap.

5.13. As such, stakeholder Pensions (introduced in 2001 by the Government) have an annual management charge of no more than one and a half per cent for the first ten years and then 1 per cent thereafter. Evidence suggests this cap on charges in stakeholder pensions placed downward pressure on charges in other types of pension schemes, in particular Group Personal Pension schemes. Typical annual management charge levels for workplace pension schemes in a 2009 survey were between 0.4 and 0.6 percent where the intermediary charged no commission and between 0.8 per cent and 1.0 per cent where commission was charged. [166]

5.14. The same survey found that pension providers and intermediaries concentrated market activity at the profitable segments of the pensions market. These segments are characterised by employers with high salary and contribution levels, high participation levels, low staff turnover and a high-degree of commitment to employee pension provision, including a willingness to pay for intermediary advice via fees.

Impact of reform on demand for pension provision

5.15. The introduction of workplace pension reforms will increase the demand for pension products. Pension providers anticipate this increase. A qualitative survey carried out by DWP with pension providers and intermediaries, into the potential response of industry to the reforms, found there was general agreement that the reforms, specifically automatic enrolment with minimum employer contribution, would increase the proportion of the population saving for retirement.[167]

5.16. Analysis by DWP, discussed in Chapter 4 shows that out of the 1.3 million employers in the private and not-for-profit sectors approximately:

- 750,000 employers currently offer no workplace pension provision[168] and will therefore need additional pension provision to comply with their duties under the Pensions Act, 2008; and

- 280,000 employers offer some provision but make less than a 3 per cent employer contribution and will need to increase pension contributions.

5.17. This means a substantial increase in pension membership. As discussed in Chapter 3, 10 to 11 million people will be eligible for automatic enrolment into a workplace pension. After accounting for opt-out we expect this to result in around 5 to 9 million people newly saving or saving more in all forms of workplace pensions.[169]

Impact of reform on the supply of pension provision

5.18. The pensions market will need to expand to accommodate the increased demand for pension products. Existing providers will increase supply of pension provision in line with their profit maximising objectives. The reforms will also introduce the

personal accounts scheme into the pensions market which will be a low-cost option designed to complement existing pension provision.

Impact of reforms on existing Pension Providers

5.19. The regulations have been designed to support existing pension provision and to ensure that the reforms strengthen the pensions market, building on the good pension provision that is already in place. For example employers currently providing schemes with high employer contributions are encouraged to maintain these schemes through postponement regulations which allow employers to postpone the automatic enrolment of jobholders into such schemes and save costs. The detail of these regulations is contained in Annex 1.

5.20. The reforms will have an effect on provider profitability. Providers will increase supply of pension products in line with these effects and their profit maximising objectives.

Impact on provider profitability

5.21. Reforms to workplace pensions will impact on provider profitability in three main ways. They will affect the:

- the cost of provision going forward;
- levels and rates of contributions being made; and
- levels that pension providers are able to charge.

5.22. Profitability of pension providers may be affected differently during the implementation of the reforms. The staged approach will allow the pension industry time to prepare their systems and processes for the expansion in pension provision. However, the implementation approach, in particular the phasing in of contributions, can limit short-term profitability for the pension industry. This is because returns to a scheme during the implementation period will be lower than if employers and employees were required to make the full 8 per cent contribution from their automatic enrolment date.

Costs to pension providers post reform

5.23. The main sources of evidence on how the costs faced by providers will change after the introduction of the reforms is a survey and modelling exercise carried out by CRA on behalf of the DWP.[170] Information was collected on:

- The set up cost per scheme;
- The set up cost per member;
- The ongoing annual cost per scheme;
- The ongoing annual cost per contributing member;
- The ongoing annual cost per non contributing member;
- The initial cost of providing advice;

- The ongoing annual cost of providing advice; and
- The annual fund management cost.

5.24. The high level results of the survey indicate that providers expect the ongoing costs of pension provision pre and post reform to be broadly the same. Costs that providers expect to decrease as a result of the reform include the cost of providing advice to employees (by up to 50 per cent) as they will no longer have to be actively persuaded of the merits of the scheme in order to opt-in. Costs identified by providers that are likely to increase as a result of the reforms are employees opting out of pension saving after they have been automatically enrolled. As a result of the automatic enrolment process, many employees will have to be entered onto the providers systems and then removed, without any pension contributions being received by the provider.

5.25. In addition to those costs identified in the survey, pension providers can face additional costs of making changes to their IT systems and administrative processes in order to provide scheme reference numbers to employers and ensure they are keeping required records, including records relating to jobholders who were automatically enrolled but subsequently opted-out. Pension providers can also face costs of providing information to the Pension Regulator. The regulations have been designed to keep burdens on pension schemes to a minimum by keeping requirements as close to what is currently normal industry practice as possible.

Contribution levels

5.26. DWP's principal estimate is that a policy of automatic enrolment and mandatory contributions from individuals and employers will generate pension saving of around £9 billion per year.

5.27. Whilst automatic enrolment is expected to increase overall revenues for pension providers, there are concerns that new savers who are currently not in pension provision have relatively low salary levels compared with individuals who are already saving in workplace pensions. Current data from ASHE shows that mean qualifying earnings for members in 09/10 earnings terms are £22,300 compared with £14,800 for non members [171] Therefore, pension contribution per member for those newly saving may be lower compared with those members who are already in pension saving.

Contribution rates

5.28. Employers with qualifying workplace personal pension arrangements will be able to continue with these arrangements for existing members. DWP research with employers in 2009 shows that of those employers who make contributions of 3 per cent or more:

- the vast majority (94 per cent) reported that they would maintain or even increase contribution levels for existing members.[172]
- About four in five (81 per cent) employers said that they would offer new employees or non-members their existing contribution levels or even higher.

- 19 per cent of employers reported they would be likely to reduce contributions for new employees.[173]

5.30 Whilst this suggests the risk of firms currently providing good pension schemes reducing or 'levelling down' their contribution levels to the minimum requirements is relatively low, it is still a concern for some stakeholders. The Government recognises this risk and is introducing a number of measures to mitigate it, including postponement periods for employers offering higher contributions and simple qualifying tests for existing schemes. We will continue to review the evidence on levelling down and monitor trends amongst employers and within the pensions industry as we approach 2012.

Charges

5.29. The personal accounts scheme is expected to be a low-charge scheme. Until the details are finalised, it is difficult to fully assess the competition impacts on the pensions market. However, given experience with the Stakeholder Pensions cap discussed in 5.14, providers expect that the level and structure of charges set by the personal accounts scheme will inform the charging structure and level of other providers in the pensions market.

Supply from pension providers

5.30. It is expected that pension providers with existing pension schemes will see an expansion in membership or an increase in contributions to meet minimum contribution requirements of around 3-4 million people newly saving or saving more in workplace pension schemes with current pension providers once the reforms are fully introduced.[174]

The Personal Accounts Scheme

5.31. Employers can choose to use the personal accounts scheme to fulfil their new duty. An estimated 3 to 6 million people will be saving in the personal accounts scheme, including some who were previously saving in existing forms of workplace pensions and some who opt-in.

5.32. Overall the reforms are expected to lead to a long-term expansion in workplace pensions. Providers and intermediaries recognise that the personal accounts scheme is designed to complement existing personal and occupational pension provision. Concern still exists, however, about the possible impact of the personal accounts scheme on the rest of the pensions market [175] - however our analysis suggests that this may not be a significant issue. It is expected that the personal accounts scheme will have different competition effects across the pensions market

5.33. It is expected that the personal accounts scheme will have a large share of the market where at present pension provision is limited. Existing providers are unlikely to actively compete with the personal accounts scheme in this part of the market because of :

- **High costs**: The Pensions Commission estimated that the cost of setting up a pension scheme will generally exceed the returns to providers when dealing with firms of 20 employees or fewer.[176]

- As discussed above for this part of the market, following the implementation of workplace pension reform, **costs to providers may increase further** and
- Pension **contributions of those newly saving will be lower** than those who are already saving in pensions.

5.34. The competition effect on the market where profitability is higher will be beneficial, for instance for those employers with a large number of members who are higher earners. In this part of the market other pension providers will be able to offer low charges and tailored products in order to actively compete with the personal accounts scheme.

5.35. The extent to which the personal accounts scheme will attract provision from existing pension providers will also be limited by the cost to employers of switching provision. This is because:

- Employers that currently offering a pension scheme to their employees (with or without an employer contribution), report that they would continue to use this existing scheme rather than change to different providers such as the personal accounts scheme as this will cost them more time and administrative burden.[177]

- In addition, the personal accounts scheme has a number of features to minimise any possible impact on the existing pension industry. These include setting an annual contribution limit and a general prohibition on transfers between the personal accounts scheme and alternative pension vehicles. These measures are described in more detail below.

Contribution Limits

5.36. In order to keep the personal accounts scheme focused on its target market and to encourage employers to continue using existing arrangements, there will be a limit on annual contributions into the scheme. Setting an appropriate level for the contribution limit involves a delicate balance between targeting the personal accounts scheme effectively and allowing individuals to save enough to achieve their benchmark replacement rates.

5.37. As the contribution limit is a fixed amount of £ 3,600 (in 2005/06 terms) it will mostly constrain those with higher earnings or in receipt of a generous employer contribution. Indeed, evidence shows that of individuals who said they might stay in the personal accounts scheme, 46 per cent were likely to contribute above the minimum on a regular basis. However, analysis shows that overall only very few (3 per cent)[178] of those would like to exceed the £3,600 annual contribution limit[179].

5.38. Although the contribution limit may constrain the savings behaviour of some in the scheme, it has been set at a level that will enable the vast majority of people in the

scheme to save in line with their retirement aspirations. Contribution limits will be reviewed in 2017 as discussed in Chapter 1.

Transfers

5.39. To reduce the risk of a substantial movement of funds from existing schemes into the scheme at the point of introduction, there is a restriction on transfers into and out of the personal accounts scheme. This will protect existing products and will signal for employers and individuals that the scheme is targeted at low to moderate earners currently without access to a good workplace pension scheme.

5.40. Although there is a general prohibition on transfers, there are limited circumstances under which it would be equitable to allow them and the regulations facilitate this. For instance, individuals who leave a qualifying scheme before their rights vest[180] will be able to transfer their cash sum into the personal accounts scheme. This could provide a significant benefit to those affected. For example, someone earning £23,000 will accumulate a fund of £2,870 in the maximum pre-vesting period of two years; if they were unable to transfer this fund to the scheme and they instead take a cash value refund, they would then lose the benefits of the employer contribution and tax relief - a loss of £1,435.

Consumer Outcomes

5.41. The current nature of demand for pensions means that there is little pressure on the current market to deliver better consumer outcomes in terms of lower prices and better quality products. The introduction of workplace pension reform and its impact on the demand for and supply of pension provision can improve present market outcomes for customers. In particular:

- The personal accounts charging regime is intended to deliver better consumer outcomes to those who do not have access to a low cost scheme in the current pensions market.
- It may lead to a more diversified product range as providers focus on differentiating their products from the personal accounts scheme. A 2008 survey identified the potential for:
    - More innovative WPPs that were bespoke and tailored to the needs of the employer: some mentioned improving communication between the employer, member and the provider; improving the ease and speed with which members could select or switch investments; and offering pensions in conjunction with flexible employment benefits packages;
    - Focus on ‘higher-end’ employers whose employees were relatively better paid, whose contribution levels were higher and staff turnover was lower, and who were seen to be less likely to consider using the personal accounts scheme;
    - Lowering charges to retain those higher-end employers who formed their market, not seeking to compete with the personal accounts scheme on price but rather differentiate in product design ways.

Chapter 6: Impact on Government

Background

6.1 Workplace pension reforms, the detail of which is described in chapter 1, will have direct and indirect effects on Government finances.

6.2 **The chapter covers four areas:**

- **Direct costs** of implementing workplace pension reform on Government where we can only give a partial picture at this stage
- The additional annual cost to the Exchequer of **tax relief** on individuals' pension contributions which is expected to be around £1.3 billion in 2009/10 prices once contributions are fully phased in. The impact on the Exchequer from increased employer contributions to workplace pension schemes is expected to be a further £850 million in 2009/10 prices once contributions have been fully phased in.[181]
- Impact on the Exchequer of expenditure on **tax credits and other income-related benefits** which is expected to be small. The increase in private pension saving due to these reforms is expected to reduce reliance on income-related benefits in retirement by around £1.3 billion per year (2009/10 prices) by 2050.
- Cost to **Government as an employer** – which are expected to be small.

Direct costs of implementing the workplace pension reforms

6.3 There are four main direct costs to Government associated with implementing these reforms:

- the costs incurred by the Personal Accounts Delivery Authority (PADA) and the Trustee Corporation in connection with their non-departmental public body (NDPB) status and their provision of advice to Government;
- the cost of setting up and maintaining an Employer Compliance Regime (ECR) by the Pensions Regulator;
- the costs of communicating the reforms to employers, individuals and existing pension providers; and
- the administrative costs of developing the policy and running the programme management office.

6.4 At this stage, we only have relatively limited information on these costs because procurement is currently underway, and the detail of these activities will be worked up in the coming months.

Setting up and operating the personal accounts scheme

6.5 PADA was set up on a time limited basis to design and develop the infrastructure for the new pension scheme and hand-over the running of that scheme to the Trustee Corporation. The Trustee Corporation, like PADA, will be a NDPB sponsored

by the DWP. The Trustee Corporation will be established on 5th July 2010 and take responsibility for the residual implementation and running of the scheme.

6.6 The key features of the Trustee Corporation and personal accounts scheme that will determine costs are:

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

Setting up and maintaining the Employer Compliance Regime (ECR)

6.7 The Pensions Regulator will be responsible for ensuring that employers meet their obligations under the Pensions Act 2008, as well as meeting their obligations under current legislation. The aim of the compliance regime is to support and help employers who wish to fulfil their duties through educating and enabling them to do so. But where employers still fail to comply, TPR will be able to take enforcement action. This is to ensure a level playing field amongst employers and to protect individuals' savings.

6.8 The Regulator has the power to outsource many of the activities needed to set up and run the ECR to private contractors by virtue of the Pensions Regulator (Delegation of Powers) Regulations 2009. It is currently procuring the services required through competitive tendering with private sector providers, and the costs will depend on the outcome of this process.

6.9 The use of outsourced providers will be in line with Treasury and Office of Government Commerce (OGC) procurement guidelines. These state that delivery of public services including all procurement of goods and services must be based on value for money, and have due regard to propriety and regularity. At this stage in the development of the ECR the Government cannot publish estimated costs due to reasons of commercial confidentiality. There is a potential risk that publishing the costs could influence the commercial process.

6.10 TPR is funded for its activities conferred by the Pension Act 2004 by grant-in-aid from the DWP. The cost of the grant-in-aid is recovered through a general levy charged to all UK tax-registered or tax-approved occupational and personal pension schemes with two or more members. The cost of setting up the ECR is currently being funded by grant-in-aid from the Department's own budget and is not being recovered via the general levy.

DWP Communications and Programme Management Office (PMO) costs

6.11 DWP directly incurs costs:

- To deliver an overarching communications strategy - this expenditure will depend on the level of communications activity required in the run up to the implementation of workplace pension reforms (as discussed in Chapter 1)
- Of a programme management office to co-ordinate delivery of the programme – this expenditure is estimated to be less than £1 million per annum.

Costs of tax relief

Tax relief for individuals

6.12 As discussed in Chapter 3, individuals receive tax relief on pension contributions[183], but pay tax on pension income – so increased pension saving will increase the amount of tax relief granted now, but in future will increase the tax paid by individuals on the their pension income.

6.13 Most of the extra tax relief will be given at the basic rate. This is because it is likely that most new savers will be basic rate taxpayers[184], and tax relief on pension contributions is given at the individuals' marginal rate of taxation. The additional annual cost to the Exchequer of tax relief on individuals' pension contributions is expected to be around £1.3 billion in 2009/10 prices once contributions have been fully phased in[185]. This compares to the £7.1 billion granted in tax relief on individuals' pension contributions in 2007/08[186].

6.14 Table 6.1 below sets out the additional cost of tax relief on employee contributions due to the introduction of the duty to automatically enrol workers over time. Some of this extra tax relief will be offset by higher tax receipts from future pensioner incomes.

Table 6.1: Additional estimated annual cost to Government of tax relief on employee pension contributions in future years (£ billion)				
	2020	2030	2040	2050
Cost of tax relief	**1.5**	**1.8**	**2.2**	**2.6**

Source: DWP modelling.

Notes: Costs are expressed in 2009/10 prices and are rounded to the nearest £100 million.

Tax relief for employers

6.15 The introduction of a minimum employer contribution is expected to increase total employer contributions by £3.4 billion (see chapter 4). This increase could also have an impact on government tax relief estimates, depending on how employers absorb their increased costs.

6.16 If employers absorb costs through profits then there will be a reduction in corporation tax paid. If employers absorb costs through reduced wage growth, the Exchequer will forego employee income tax and National Insurance contributions from both employer and employee. If employers absorb costs by increasing prices, there is no direct impact on their tax bill[187].

6.17 Quantitative evidence from the Employers' Attitudes Survey 2007[188] shows that 45 per cent of employees work for an employer who said they would absorb the cost through profits, and 25 per cent of employees work for an employer who said they would absorb the cost through wages. The remainder work for an employer who does not expect to face increased costs, or would absorb an increase through prices, or in some other way.

6.18 Using this evidence, we expect the impact on the Exchequer from increased employer contributions to workplace pension schemes to be a further £850 million in 2009/10 prices once contributions have been fully phased in[189].

6.19 Table 6.2 below sets out the additional cost to the Exchequer due to the introduction of the duty on employers to make pension contributions.

Table 6.2: Additional estimated annual cost to Government of employers adjusting to increased pension contributions in future years (£ billion)				
	2020	2030	2040	2050
Cost of tax relief	1.0	1.2	1.4	1.8

Source: DWP modelling.

Notes: Costs are expressed in 2009/10 prices and are rounded to the nearest £100 million.

6.20 Our estimate of the total cost to the Exchequer is within the range of the last estimate published in the Impact Assessment that accompanied the introduction of the Pension Bill 2008 into Parliament.

Impact on expenditure on Tax Credits and Income-Related Benefits[190]

6.21 The introduction of automatic enrolment and minimum contribution rates will mean that millions of people will be making pension contributions for the first time, or making higher pension contributions than before. This could have an impact on entitlement to tax credits and to income-related benefits such as Income Support, Income-based Jobseekers Allowance, Housing Benefit and Council Tax Benefit during working life, and to income-related benefits such as Pension Credit, Housing Benefit and Council Tax Benefit during retirement.

Tax credits and income related benefits during working life

6.22 As explained in chapter 3, an individual's contribution to a private pension scheme is fully disregarded from their income when calculating entitlement to tax credits. Eligibility criteria for tax credits are complex. DWP analysis suggests that 2.3 million family units are in receipt of tax credits with at least one member eligible for automatic enrolment. Of these, around 30 per cent would see a small change to their tax credit entitlement. Because we estimate that entitled non-recipients and new claims for tax credits will remain low, the impact on the Exchequer is expected to be low. See chapter 3 for more information.

6.23 Half an individual's contribution to a private pension scheme is disregarded from their income when calculating entitlement to income-related benefits. DWP analysis suggests that around 240,000 jobholders who are in receipt of an income related benefits (Income Support, Council Tax Benefit, Housing Benefit and Income-based Jobseekers Allowance) will be eligible for automatic enrolment. Of these around half are also in receipt of tax credits. Some of these individuals will also be entitled to a higher benefit award, but again the total impact on the Exchequer is expected to be small.

Income-related benefits in retirement

6.24 Individuals whose income falls below a certain level may be entitled to income-related benefits. For these individuals, the Government provides support through Pension Credit to ensure a guaranteed minimum income for those currently aged 60 and over and to reward those who have been able to make small amounts of private savings.

6.25 Assuming that the current benefit rules continue to apply, the increase in private pension saving due to these reforms is expected to reduce reliance on income-related benefits in retirement. By 2050 around £200 million per year (2009/10 prices) less might be spent on Pension Credit, equivalent to 7 per cent of projected expenditure on Pension Credit. This compares to £11 to14 billion extra generated in additional private pension income in the same year.

6.26 Individuals may also be eligible to receive Housing Benefit or Council Tax Benefit. By 2050 around £1.1 billion per year (2009/10 prices) less might be spent on Housing Benefit and Council Tax Benefit as a result of the additional private pension income generated by the reforms. This would be equivalent to 9 per cent of projected expenditure on Housing Benefit and Council Tax Benefit in that year.

6.27 This estimate of savings on income related benefits is higher than our previous estimate of £650 million (2007/08 prices), contained in the Pensions Bill Impact Assessment published on 24 April 2008. This is due to improvements to the Department's dynamic micro-simulation model, Pensim2, which now shows that those newly saving as a result of the reform will, on average, receive more pension income in retirement than we previously estimated, and so are less likely to be in receipt of income-related benefits.

Costs to Government as an employer

6.28 The workplace pension reforms introduced by the Pensions Act 2008 apply to all employers with eligible jobholders, including those in the public sector. The costs of additional pension provision to public sector organisations has not been estimated here, but we expect many costs associated with contributions and administration to be small, as pension provision and membership in the public sector is already high. The Annual Survey of Hours and Earnings shows that the majority of public sector employees are members of an employer-sponsored scheme (80 per cent of employees or 5.5 million employees in 2008.[191] It is estimated that there are around 600,000 individuals working in the public sector that are in the group eligible for automatic enrolment[192] and whose employers will need to enrol them in a qualifying automatic enrolment scheme.

Annex A: Impact on small firms

A.1. The Government's reform programme continues to place employers at the heart of pension provision, and can only be successful with the ongoing support and involvement of employers. Many employers in the UK are already making a substantial contribution to their employees' pension schemes and are supporting them in saving for retirement. At present, one in five micro firms and two in five small firms have pension schemes which attract active membership. Around three quarters of these schemes provide an employer contribution of 3 per cent or more.[193] However, for the reforms to be fully successful, those employers who do not already contribute to pensions need to play a role.

A.2. There are a number of characteristics particular to small firms which mean that workplace pension reform can affect them differently compared with larger firms. The Government is aware of these challenges faced by small firms and is keen to see that they are not disadvantaged by the reforms.

What is a small firm?

A.3. There is no single definition of a small or medium sized firm. The, general approach is to regard all businesses having fewer than 50 employees as being Small. This is the definition we have used in this Annex. When referring to Small and Medium Sized Enterprises (SMEs) we refer to businesses with fewer than 250 employees. In our analysis we have broken down this definition further into:

- Micro firms are those who have between 1 and 4 workers;
- Small firms are those who have between 5 and 49 workers; and
- Medium firms are those who have between 50 and 249 workers.

Issues faced by the smallest firms

A.4. Most of the 1.3 million private sector enterprises in the UK are small, and almost all new firms created each year are small employers. Small firms, with fewer than 50 employees, represent 97 per cent of private sector enterprises and 37 per cent of private sector jobs. In contrast there are only 7,000 large firms each employing more than 250 people. [194]

A.5. Small firms are likely to have a number of structural differences compared to their larger counterparts. Notably, these are:

- a business infrastructure that operates on a relatively small scale, leading to limited internal flexibility. This potentially makes it difficult and more costly for small firms to implement new regulatory requirements;
- limited resources which could make it difficult for them to respond to government consultations; and
- for the same reasons, proportionately very few are members of employer associations.

Consultations with representative groups

A.6. DWP has consulted with small businesses and their representatives on the pension regulations assessed in this impact assessment. DWP's consultation has included discussions with the following employer groups to take their views into consideration. In particular for small firms DWP has consulted with:

- the Small Business Council;
- the British Chambers of Commerce;
- the Federation of Small Businesses;
- the Confederation of British Industry;
- the Engineering Employers Federation;
- the Food and Drink Federation;
- the Association of Convenience Stores; and
- Institute of Directors.

A.7. DWP has also been in consultation with the Department for Business, Innovation and Skills and also sought their views on engagement with, in particular, small employers. Beyond consultation with these groups, DWP has also consulted with small employers directly throughout the policy development process and thought its research programme.

A.8. Most recently, DWP arranged three seminars with employers of all sizes, employee benefit companies, consumer representative organisations, and intermediaries to discuss the regulations during the consultation period. At the same time DWP commissioned qualitative research with small and medium sized employers about the impact of the second batch of regulations on their businesses. The study consisted of focus groups and individual depth interviews with 66 private sector businesses of up to 500 employees.[195]

Employers' response to the legislation

A.9. DWP research with employers shows that there is considerable support for the idea of automatic enrolment with an employer contribution among employers of all sizes. [196] Looking at the smallest employers with fewer than 5 employees, 58 per cent of micro-employers thought the reforms were a good idea. Responses from small employers -those with between 5 and 49 employees- was similar with 50 per cent of such employers saying they thought the reforms were a good idea

A.10. The fieldwork for this survey took place in summer 2009, at a time of economic uncertainty. Given that we expect economic recovery by the time the reforms are rolled out, more employers may feel better able to support the reforms by the time the legislation comes into force.

A.11. To understand how small employers are likely to respond under different economic scenarios, DWP recently undertook qualitative research as part of its

ongoing consultation with employers.[197] This comprised 8 discussion groups and 28 follow-up face-to-face interviews with employers with 1 to 49 workers across a range of sectors. The research showed that prior to the information provided as part of the research, employers had a limited awareness of the reforms. Some had heard about them from their accountants, but had not taken any steps to prepare for implementing the reforms. This is not unexpected at this early stage of the reform process. These responses are in the absence of any detailed information and communication campaign to date. As discussed in Chapter 1, the Government will provide employers with information and support before and during the implementation of the reform.

A.12. The delivery bodies will also help and support employers during the implementation of the reforms. There will be a group of smaller firms who will be brought under the duties earlier than similar sized firms. This will enable both the PA scheme and TPR to test their systems and make changes to processes as they learn from dealing with this new client base. The PA scheme also intends to begin enrolling members on a voluntary basis ahead of the launch date in order to test systems and processes which will help to minimise costs and smooth the process for employers during implementation.

A.13. The qualitative research with small firms also showed that although there was broad support for the general aims of the reforms, the economic climate at the time of the fieldwork meant that small employers were concerned about any increase to the cost of their businesses.

The impact on small firms

A.14. Like all firms, smaller firms will face the costs of employer contributions to their employees' pension savings and administrative costs of implementing the reform.

A.15. As discussed in Chapter 4, employers have several ways of managing the additional costs of the reforms. Micro and small firms were most likely to say that they would absorb the increase through overheads (30 per cent and 23 per cent), increased prices (21 per cent), or lower wage increases (12 per cent and 20 percent), or restructure their workforce (8 per cent). A number of micro and small employers (11 per cent and 7 per cent) suggested that they might encourage their employees to opt out.[198] As highlighted in chapter 1, the compliance regime will aim to mitigate this risk.

A.16. The recent qualitative research with small employers showed that there were concerns about the cost implications of the reforms. This is to be expected in the current economic climate, particularly among firms currently without pension provision. Within the current economic climate small employers were primarily focused on maintaining their business and so were concerned about the potential burden expanding pension provision will impose in future.

A.17. When asked how they would manage contribution costs under a variety of economic scenarios, small employers reinforced the messages from the 2007 Employer Attitudes Survey, in that they would absorb costs through profits, prices and wage bills. However, they felt that the economic climate would have a significant

impact on the mechanism they would be able to use. Under positive economic conditions, as recorded in 2007, they felt confident they would be able to absorb additional costs through profits and prices. However, in a time of continued economic uncertainty they felt they were more likely to absorb costs through reductions in their swage bill, and this may also result in a reduction in headcount or hours worked.

A.18. At present, according to independent forecasts collated by HM Treasury in November 2009, on average, experts are expecting Gross Domestic Product growth of 2.3 per cent in 2012 and 2.7 per cent in 2013.[199] This means that the economy is set to recover before the reforms are introduced. This is particularly true for smaller firms who will only be staged in after the large and medium sized firms.

Contribution costs

A.19. The additional cost of minimum employer contributions will depend on whether employers already provide and contribute to their employees' pensions. It will also depend on the number of employees who participate in pension saving at present, and the number of employees who choose to opt out of pension saving when they are automatically enrolled into their workplace pension.

A.20. SMEs overall are expected to bear around £2.1 billion of additional contribution costs once contributions have been fully phased in. This equates to £0.4 billion for micro firms, £1.1 billion for small firms and £0.6 billion for medium sized firms[200]. This represents, on average, a 0.9 per cent rise in total labour costs for small and micro firms and a 0.7 per cent rise for medium firms[201]. This compares with an overall increase in total labour costs for all firms of 0.6 per cent. The exact cost for each firm will depend on their specific circumstances, but averaging across all firms gives annual contribution costs of around £500, £2,800 and £22,100 for micro, small and medium firms respectively.

A.21. Figure 4.1, in chapter 4, shows that employees working in large firms are more likely to be in a pension scheme and to be receiving relatively generous employer contributions compared with those working for small and micro-sized firms. As a result we expect small firms will face higher costs relative to large firms, as their employees are less likely to be currently participating in a pension with an employer contribution.

Administrative costs

A.22. In the April 2008 Pensions Bill Impact Assessment, the DWP estimated the administrative costs to employers of workplace pension reform. This was the result of a cross-Government working group[202] set up to refine the Government's assessment of the administrative cost impact of the reforms on employers.

A.23. The majority of the work of the group is still valid and is reflected in the latest estimates of administrative costs of the reforms. The processes have been updated to reflect the policy detail that is provided by the regulations and new research and estimates of participation.

A.24. Our latest estimates suggest that small and micro firms will incur an administrative cost of around £311 million in the first year and around £107 million in following years. These costs are illustrated in more detail in Chapter 4 and Annex G. This is the compliance cost and administrative burden associated with enrolling eligible workers into either an existing or a new qualifying workplace pension scheme.[203]

A.25. Table A.1 below summarises the impact on small firms.

Table A.1: Estimated Administrative Costs for small firms

Firm size (number of employees)	1-4	5-49	50-249
Number of firms	804,000	386,000	28,000
Number of automatic enrolments	1,500,000	3,300,000	1,800,000
Year 1 administrative costs (£ million)	173	138	50
Ongoing administrative costs (£ million)	66	41	10
Costs of minimum employer contribution (£ million) Year 6	400	1,100	600
Percentage of labour costs Year 6 onwards	1.0%	0.9%	0.7%

Source: Number of firms Small and Medium-Sized Enterprise (SME) Statistics 2007.
Employer contribution DWP analysis based on Employers' Pension Provision Survey 2007, Small and Medium-Sized Enterprise (SME) Statistics 2007, and Annual Survey of Hours and Earnings 2008
Administrative costs based on DWP modelling
Notes:

- Figures for employer contributions rounded to the nearest £100 million;
- Number of firms and individuals rounded to the nearest 1,000 and 100,000 respectively
- Numbers in the table may not match to totals in text due to rounding;
- Contributions are based on 2009/10 earnings, they are not up rated to take into account earnings growth until 2012. Uprating for earnings growth would increase the costs in nominal terms, but not as share of labour costs or earnings terms; and
- Figures for administrative costs are rounded to nearest million and are expressed in 2009/10 prices.

A.26. While the assumptions underlying these estimates have been carefully considered, there is inevitably some degree of uncertainty around the actual cost of these reforms to employers. The costs will depend on a range of factors that may vary between the time the assumptions are made and the introduction of the reforms for small firms.

A.27. DWP research with small firms in particular found that small employers had difficulty estimating the time and cost of the administrative processes that would be undertaken as a result of these reforms. [204] For many small firms payroll and accounting systems are often outsourced and so it would be difficult to determine the exact cost of a system update to take account of adjustments.

A.28. Those firms who dealt with their payroll in-house generally worked with computerised systems and were therefore already reliant on the software provider for automatic updates, and so felt that the administrative elements of the reforms could be dealt with relatively easily through software changes. The administrative costs in Annex G include the costs of adapting or purchasing an in-house or internal payment system. These are one-off costs of £5.1 and £19.5 million for micro and small firms respectively. The additional costs associated with outsourced payroll have been included in the administrative costs base on research carried out by Middlesex University Business School.[205]

A.29. In addition, small employers had generally found previous legislative changes (such as National Minimum Wage and maternity legislation) relatively easy to manage, in terms of both costs and administrative change, and that the support and information available from the Government on these changes had been helpful.

A.30. The Government will continue to monitor trends in pension provision, the economic context in which these reforms will be introduced and gather evidence on the attitudes of employers, to the reforms. The programme intends to fully evaluate the effects of the reforms against the policy objective of getting more people to save more for retirement. The evaluation will also assess the impacts of the reforms on employers, to evaluate the extent to which this policy objective is met whilst putting minimal burden on employers and maintaining current good pension provision

Compliance

A.31. As part of its consultation with employers, the DWP has sought views on the design of the compliance regime. Stakeholders have shown general agreement with the main principles of a proportionate, risk-based approach, which makes use of automated data-matching processes rather than relying solely on individuals to take action themselves through whistle-blowing or an employment tribunal.

A.32. The compliance regime may come into contact with small employers by three main routes: education and information, the registration requirement, and further interventions such as letters or investigations for some employers.

A.33. An effective communication strategy will be used to help minimise the cost to employers and the need for enforcement action by making sure that employers know what they are required to do and when to do it. The Pensions Regulator is planning to write to each employer 12 months and 3 months before their duties fully outlining what they need to do. The Government recognises that this will be particularly important for smaller employers who are currently less likely to be making contributions to workplace pension schemes and therefore will be unfamiliar with the steps required to comply.

A.34. While some elements of the burdens created by the reform, such as contribution costs vary considerably by firm size, the cost of registering will be dependent on the number of pay as you earn (PAYE) schemes that the employer operates and therefore needs to register. Although the largest employers are more likely than small ones to have more than one PAYE scheme, the vast majority of PAYE schemes are

run by small employers who are likely to have only one which will minimise the cost of registering. Table A.2 shows the estimated cost of registration.

A.35. Further costs will occur if an employer does not fulfil their legal obligation and is subject to an enforcement activity. However, the automated follow-up to the registration process should ensure that small employers who are initially unaware of their duties, or experience a delay in registering will have a further opportunity to become compliant and avoid becoming subject to more intrusive investigation at a later date.

Table A.2: Estimated Costs for small firms of registration

Firm size (number of employees)	1-4	5-49	50-249
Cost per employer of registration	15	10	20
Cost of registration in Year 1 (£ million)	12	4	1
Cost of registration in subsequent years (£ million)	1.8	0.5	0.1
% of total administrative costs from reform in Year 1	7%	3%	1%
% of total administrative costs from reform in subsequent years	3%	1%	1%

A.36. One of the key aims of the compliance regime is to ensure there is a level playing field for employers. It will aim to prevent non-compliant employers from gaining an unfair advantage over the majority who will meet their new duties. For small employers that face strong competitive pressures, this will be a valuable part of the Pension Regulator's new work.

Policies to aid small employers

A.37. Employers will be the key to ensuring the success of the workplace pension reforms and minimising burdens on employers where possible is a key reform commitment. A number of policies have been included to minimise the costs to business. Those with particular relevance to small firms are:

- Reassurance that minimum contributions will not be raised by placing these in the primary legislation;
- The criteria by which schemes will qualify for automatic enrolment will be as simple and as straightforward as possible;
- Staging the employer duties starting with the largest firms with small and micro firms being staged later. This approach also provides both delivery authorities the opportunity to adjust systems and processes based on experience from early stages to help and support smaller firms who are staged in later;
- Phasing employer contributions over a period of time. The minimum employer contribution will stand at 1 per cent from October 2012, 2 per cent from October 2016

and 3 per cent from October 2017. Table 4.7 in Chapter 4 illustrates the difference between contribution costs smaller firms have to make during the implementation period compared with a situation if the reforms had been implemented instantaneously in 2012.

- A delivery model for the personal accounts scheme that minimises burden on employers; and
- An employers' panel will be set up to feed in views to the personal accounts scheme trustees.

A.38. A number of small employers and their representative groups have suggested that small employers may require more help than larger employers in adjusting to their new duties and have called for financial support. The Government recognises that the smallest businesses may have the most difficulty in managing the additional costs. At this stage the Government has focused on ensuring that the design of the policy minimises the impact of the reforms on employers as far as possible. Any financial support for small firms in particular would be a decision for the future based on the fiscal position at the time.

Annex B: Competition assessment

Background

B.1 The reforms detailed in the Pensions Act 2008 and the pension regulations affect the market for pension saving and specifically the market for pensions organised through the employer. As well as the impact on the pensions market sponsored by the employer, there are also indirect impacts on other areas of the market, for example on the pensions market for the self-employed.

B.2 This competition assessment covers seven key points:

- Definition of the market being discussed;
- Current nature of competition in the market;
- The Competition Test against which the reforms are assessed;
- The impact of the reforms on competition in the product, labour and financial advice market;
- Impact of the reforms on competition in the pensions market;
- Impact of reforms on the services markets which supply the personal accounts scheme; and
- Impact on reforms on other saving products.

Definition of the Market

B.3 Key market operators affected by these reforms include:

- Financial intermediaries, such as independent financial advisers.
- Pension providers (including long-term life insurance companies), who market and sell pension products;
- Providers of administrative services supporting pension provision;
- Providers of financial savings products other than pensions;
- Managers of funds invested by individuals, companies and Governments, in equities, bonds, derivatives and so on; and

B.4 Other markets can also be affected. For instance, the bank sector may be affected if they provide some or all of the services covered by the sectors listed above, for example through fund management or the provision of administrative services to pension providers.

B.5 As the Act and pension regulations set minimum requirements for employer contribution to employees pension scheme it is possible that the policy will have an impact on the labour market. This is because workplace pension reforms will have an impact on the package of benefits that employers are able to offer employees to join and remain in the firm.

Current nature of competition

B.6 The pension provider market is relatively concentrated, with the top five firms covering 57 per cent of the market and the top 10 having 80 per cent.[206]

B.7 The fund management market is less concentrated, with the top five firms covering 27 per cent of the market and the top 10 having 45 per cent.[207] Sub-markets are also fairly concentrated, for example the largest three group stakeholder pension providers have around 50 per cent of the market and the largest seven providers around 90 per cent.[208] The Pensions Regulator has 45 providers in total on their register of stakeholder pensions.

B.8 The financial intermediaries sector is predominantly made up of small firms. Of the 44,000 independent financial advisers, 93 per cent are in firms that normally consist of one or two advisers.[209] Employers also play a major role as a provider of occupational schemes, part of which may be outsourced to a third party administrator or pension provider. In addition, the pension provider and fund management markets are characterised by a high degree of vertical integration with several of the top ten investment management firms being owned by, or part of a wider group with, a top 20 pension provider.

B.9 The present market offers little incentive for pension providers to reduce costs or to improve service. A survey of intermediaries on their perceptions of the pension market found that there was a general feeling throughout that the products offered by pension providers were all similar and that there was little differentiation in the market[210].

B.10 This is because in the pensions market the demand side pressure for pension products is weak. As discussed in Chapter 5, this can be attributed to the unique nature of pension products which unlike other products cannot be experienced immediately or frequently. Where there is consumer power through regular repeat purchasing, customers dissatisfied with product quality or value for money can quickly switch to another brand. However individual consumers of pensions cannot gain experience of the product in this way.[211]

Competition Test

B.11 In line with the guidance from the Office of Fair Trading, workplace pension reforms have been assessed with respect to their potential to:

- Directly limit the number or range of suppliers;
- Indirectly limit the number or range of suppliers;
- Limit the ability of suppliers to compete; and
- Reduce suppliers' incentives to compete vigorously.[212]

Impact of reforms on competition

Impact on the product market[213]

B.12 The employer duty to automatically enrol all eligible employees and contribute a minimum 3 per cent of qualifying earnings to their pension saving applies to all employers. The extent to which these policies impact on competition in the goods market depend on how employers choose to absorb the costs of reform. Workplace pension reforms will increase costs for employers, particularly those who do not currently provide pensions and those who currently have low levels of pension membership among their workforce.

B.13 Around one-fifth (21 per cent) of employers said they thought they would adjust to increased costs through price increases for consumers.[214] Competitive pressures in the market within which employers operate both in the domestic market and internationally, will determine the degree to which employers are able to use this mechanism to cope with the costs.

B.14 There may be additional short run impacts on competition in the goods market arising from the implementation design. As discussed in Chapter 4, this is because employers can be competitively disadvantaged in the products market if they are staged in to the reforms earlier than their competitors and if they choose to absorb costs by increasing prices.

Impact on the labour market

B.15 Employer duty to automatically enrol all eligible employees and contribute a minimum 3 per cent of qualifying earnings to their pension saving should not reduce competition between employers in the labour market. The policy means that employers who currently do not offer pension provision or contributions can now use this as an instrument to attract or retain employees similar to employers who currently offer pension provision to their employees.

B.16 The extent to which these policies have an additional impact on competition in the labour market depend on how employers choose to absorb the costs of reform 14 percent of employers said they thought they would deal with the additional costs of reform through increased costs through slowing the rate of wage growth. Furthermore, 8 percent of firms said they would re-structure or reduce their workforce.[215]

B.17 Labour market competition impacts may be stronger in the short run as a result of the implementation design.

Impact on the financial advice market

B.18 Large changes in the financial advice market are expected prior to the commencement of the reforms. Establishing the impact of the reforms and in particular of the personal accounts scheme on this changing market is therefore difficult. The changes are in response to concerns that the current market may not be delivering good customer outcomes due to characteristics such as non-transparent linking of payments for provision and pension advice, via commission payments to advisors from providers.[216]

B.19 By the start of the reforms the outcome of the retail distribution review will be known. Current changes to the financial advice market that are being consulted on include requirements for financial advisors to hold minimum levels of qualification, or meet ongoing professional assessment requirements,[217] and for remuneration of advisors to be more transparent to consumers of occupational and workplace pensions.[218]

B.20 Employers will not have to go through financial advisors to purchase a pension scheme (including the personal accounts scheme). Employers may of course choose to approach an advisor, to obtain an informed recommendation of which qualifying pension best meets their needs and requirements, and may pay a fee for this service. Employers using the personal accounts scheme to fulfil their new duties therefore may avoid the cost of payments to financial advisors.

Impact on the pensions market

B.21 As a result of these reforms, we expect that around 10 to 11 million people will be eligible for automatic enrolment into a workplace pension. After accounting for opt-out we expect this to result in around 5 to 9 million people newly saving or saving more in all forms of workplace pensions.

B.22 Employers can choose to use the personal accounts scheme fulfil their new duty. It has been designed, as far as possible, to complement existing pension provision by enabling employers, who wish to use it. An estimated 3 to 6 million people will be saving in the personal accounts scheme, including some who were previously saving in existing forms of workplace pension scheme, and some who opt in.

B.23 Overall the reforms are expected to lead to a long-term expansion in workplace pensions. Providers and intermediaries recognise that the personal accounts scheme is designed to complement existing personal and occupational pension provision. Concern still exists, however, about the possible impact of the personal accounts scheme on the rest of the pensions market [219] however our analysis suggests that this may not be a significant issue. It is expected that the personal accounts scheme will have different competition effects across the pensions market

B.24 It is expected that the personal accounts scheme will have a large share of the market where at present pension provision is limited. Existing providers are unlikely to actively compete with the personal accounts scheme in this part of the market because of:

- **High costs**: The Pensions Commission estimated that the cost of setting up a pension scheme will generally exceed the returns to providers when dealing with firms of 20 employees or fewer.[220]
- As discussed above for this part of the market, following the implementation of workplace pension reform, **costs to providers may increase further** and
- Pension **contributions of those newly saving will be lower** than those who are already saving in pensions.

B.25 The competition effect on the market where profitability is higher will be beneficial, for instance for those employers with a large number of members who are higher earners. In this part of the market other pension providers will be able to offer low

charges and tailored products in order to actively compete with the personal accounts scheme.

B.26 The extent to which the personal accounts scheme will attract provision from existing pension providers will also be limited by the cost to employers of switching provision. This is because:

- Employers that currently offering a pension scheme to their employees (with or without an employer contribution), report that they would continue to use this existing scheme rather than change to different providers such as the personal accounts scheme as this will cost them more time and administrative burden.[221]

- In addition, the personal accounts scheme has a number of features to minimise any possible impact on the existing pension industry. These include setting an annual contribution limit and a general prohibition on transfers between the personal accounts scheme and alternative pension vehicles.

B.27 In order to keep the personal accounts scheme focused on its target market and to encourage employers to continue using existing arrangement, there will be a limit on annual contributions into the scheme. As the contribution limit is a fixed amount of £3,600 (in 2005/06 terms) it will mostly constrain those with higher earnings or in receipt of a generous employer contribution. Findings from a survey of individuals' attitudes and likely reactions to the personal accounts scheme suggests that of those who said they might stay in the scheme, 46 per cent were likely to contribute above the minimum on a regular basis. However, analysis shows that overall only very few (3 per cent)[222] of those who said they would stay in the personal accounts scheme would be likely to exceed the £3,600 annual contribution limit.[223]

B.28 The ban on the transfer of accrued benefits into and out of the personal accounts scheme, apart from in a limited number of circumstances, will also act to restrain the utilisation of the scheme by firms with existing pension provision taken up by a substantial proportion of employees. [224] Often, when a private pension providers takes over the supply ongoing pension provision from another provider, it is able to transfer the employees pre-existing pension funds into its' own scheme. This simplifies the ongoing pension administration arrangements for employer and employee alike; switching providers is a more attractive proposition.

B.29 The possibility of having existing pension funds transferred to the management of a provider, and the immediate income this generates, increases competition amongst providers, for employers with existing pension provision. In the longer run the transfer ban in place for the personal accounts scheme may inhibit the ability of other pension providers to compete to takeover the pension provision of firms using the personal accounts scheme.

B.30 We are legislatively committed to a review in 2017 which will cover those features of the personal accounts scheme that are designed to focus it on the target market specifically; the annual contribution limit and the prohibition of pension fund transfers to and from the Scheme. The evaluation of the reforms will feed into this review, as appropriate.

Customer outcomes

B.31 The introduction of workplace pension reform and its impact on the demand for and supply of pension provision can improve present market outcomes for customers. In particular:

- The personal accounts charging regime is intended to deliver better consumer outcomes to those who do not have access to a low cost scheme in the current pensions market.
- It may lead to a more diversified product range as providers focus on differentiating their products from the personal accounts scheme.

Competition impact on markets from which the personal accounts scheme contracts services

B.32 The trustees of the personal accounts scheme will work in the best interests of members to ensure low charges, ensuring that firms compete for time-limited contracts. In the short run, the nature of competition will be different in the personal accounts scheme than in the overall market, with providers competing for contracts to serve this segment of the market rather than directly for consumers. In the long run any potential losses of dynamic efficiency gains and product innovation will be mitigated by contract specifications and periodic renewal.[225]

B.33 The personal accounts scheme will be delivered using capabilities procured from the private sector. All contracts will be let in accordance with the Public Contracts Regulations (2006) and adhere to best practice to ensure effective and fair competition for contracts. The appointments to the scheme Trustee Corporation will be made with regard to securing best value for money. The personal accounts scheme will be set up as a trust as this is the best way to provide transparency.

B.34 Contracts for investment management and for fund accounting and custodian services will be let for 10 year periods. The investment management contract will be let to multiple suppliers to strive for value for money and is intended to be assessed continuously on fund performance. If appropriate performance is not in evidence, in comparison with external performance, it will be possible to terminate a contract with a supplier at any time at trustees' discretion.

B.35 The scheme will enter into a long term supply contracts with a single supplier for fund accounting and custodian services to give continuity of service. This contract will stipulate specific service standards that are to be met throughout the length of the contract, with the scheme having the right to review or termination of the contract should these standards fail to be met. The competitiveness of these standards in relation to other providers will be periodically reviewed, and re-benchmarking can occur if standards, at a given real price, are shown to have risen significantly since the commencement of the contract. These reviews would also incorporate an assessment of any future needs and requirements for the personal accounts scheme.

B.36 The decumulation process will utilise the existing methods of competition in the annuity market through giving individuals the use of the open market option to choose their annuity.

Competition Impact on non-pensions savings products

B.37 Some savings in the personal accounts scheme will be diverted from existing savings products. This could be transfer of savings from other pension or other saving products.

B.38 This is equivalent to less than half of one per cent of Gross Domestic Product. This estimate is based on a review by Pricewaterhouse Coopers of relevant UK and international evidence. The report compares particular features of the reforms to workplace pensions planned in the UK with other experiences to estimate that households are likely to offset 30 to 50 per cent of savings in pensions from existing sources of saving. [226] The report estimates that offset effects typically be higher than 50 percent for higher income groups (with greater stocks of other assets), and typically less than 30 percent for lower income groups. This is discussed in more detail in Chapter 2.

B.39 It is difficult to say whether the participants of the personal accounts scheme will have higher offset rates than the 30-50 percent estimate discussed above. Research by the Institute of Fiscal Studies (IFS) has looked at the current financial balances of the personal accounts scheme target groups, principally through examining the net liquid assets of this group.[227]

B.40 The IFS found that those without pension saving had no median net liquid assets. This finding is driven by individuals not currently in a private pension having less savings and investments than other individuals, rather than them having larger debts. These individuals without a private pension are expected to make up the vast majority of the personal accounts scheme membership. Their lack of other savings and investments will mean that they will not be able to substantially offset savings into the scheme by running down other financial assets. Additionally, many will be credit constrained, particularly as credit markets lend more conservatively in the future and may not be able to offset contributions by increasing their debt.

Annex C: Gender impact assessment

Gender Inequality in Pension Saving

C.1 There is a legacy of inequality between men and women in pension saving. A number of factors have historically caused inequalities in both private and state pension income.

C.2 Patterns in the labour market have affected women's ability to build up state pension entitlements, as well as the level and frequency of private pension contributions they make.

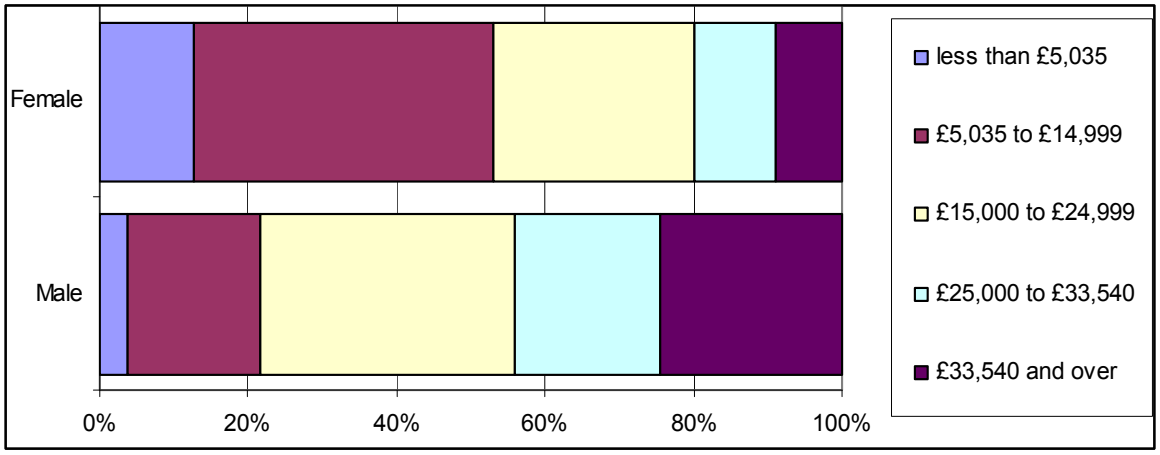
C.3 Reforms to the state pension system, implemented by the Pensions Act 2007, will significantly contribute to making future pensioners, and in particular women, better off. On its own however, the State Pension system will not provide the retirement income that many people want.

Gender Employment Patterns

C.4 The employment rate gap has narrowed, but it still exists - women are still more likely than men to be working part-time and have broken work histories due to economic inactivity when women do not work due to for instance caring responsibilities rather than unemployment. Gender differences in types of occupations, all contribute to the disparity in pension provision. [228]

C.5 Women are also more likely to be lower earners, a group that is not well served by the pensions market. Figure C.1 shows how women are both under-represented in the population of employees earning over £33,540 and over-represented in the population earning less than £5,035.

Figure C.1 Distribution of employees by earnings and gender



Source: UK Family Resources Survey 2005/06. Analysis based on employees aged 22 to State Pension age

C.6 The likelihood of being in work affects the likelihood of participating in a private pension scheme. Only around 40 per cent of women contribute to a private pension,

compared to around 56 per cent of women who are in work. The proportion of men contributing to a private pension is around 46 per cent, compared to around 59 per cent of men who are in work.[229]

C.7 However, these figures mask the fact that women are more likely to work in the public sector where workplace pension scheme membership is higher. If we compare provision by sector, around 48 per cent of male and 39 per cent of female private sector employees contribute to a workplace pension. Participation increases to around 90 per cent of male and 85 per cent of female public sector employees contributing to a workplace pension.[230] This suggests that given the same opportunities, women are as likely as men to contribute to a workplace pension scheme.

Impact of workplace pension reform on gender disparity in pension saving

C.8 These reforms will provide employees with access to a workplace pension scheme, with minimum employer contributions. They will provide a strong incentive for employees to participate in a pension scheme and ensure equality of access to a workplace scheme of a minimum standard, giving many millions of men and women the same opportunity to build up a private pension.

C.9 There are also a number of behavioural and informational barriers to making private provision for retirement. Automatic enrolment into a qualifying workplace pension scheme will help tackle the problem of inertia and lack of confidence in making financial decisions, which appear to be more significant barriers for women than men in saving in a pension scheme. Research on the 401(k) experience in the United States show that in that particular instance automatic enrolment had the greatest effect among people on low incomes, people from minority ethnic groups and women who have lower participation rates. [231]

C.10 The latest Government estimates show that 10 to 11 million people will be eligible for automatic enrolment into a qualifying workplace pension scheme of which we expect 4 to 5 million to be women.[232] There are more men than women in the group eligible for automatic enrolment because women are more likely to be economically inactive or work in the public sector. These estimates represent around two thirds of private sector employees aged 22 and earning more than £5,035 for both men and women. Many of these individuals will be gaining access to a workplace pension scheme with incentives to save for the first time.

C.11 Taking these participation rates into account we expect around an additional 2 to 3 million women and 3 to 5 million men to newly participate in a workplace pension scheme. In addition, around half a million people who are already saving will benefit from a higher employer contribution.

C.12 The introduction of the personal accounts scheme and the employer duty to automatically enrol will give employers a choice about where workers will be automatically enrolled[233]. In total we estimate that 3 to 6 million individuals will participate in the personal accounts scheme and that 1 to 2 million of them will be

women. We expect higher levels of participation in the scheme in subsequent years[234].

C.13 Alongside the improvements in women's labour market position relative to men, these reforms will offer substantial opportunities for women to build up private pension savings in their own right. If women save earlier as a result of these reforms this will help to substantially increase their final pension entitlement at retirement.

C.14 Due to these reforms, a large majority of men and women can expect to benefit from saving into a workplace pension scheme, with good incentives to save at the point they are automatically enrolled. This is true for those who expect to work most of their working life, irrespective of their income level. Individuals can expect to gain both in financial terms and in the security offered by building up their own pension assets.[235]

C.15 The implementation approach will initially have a slightly adverse effect on women as they are more like to work in smaller firms and therefore be staged in later. [236] Women are also more likely to have career breaks and will therefore have less time to build up their savings.[237] This is because the contributions foregone represent a larger proportion of their potential savings.

C.16 The PA scheme will be subject to legislation requiring the trustees or managers of a pension scheme not to discriminate on grounds of gender etc. The requirement for an equal treatment rule is currently in section 62 of the Pensions Act 1995 and is also contained in the Equality Bill currently going through Parliament.

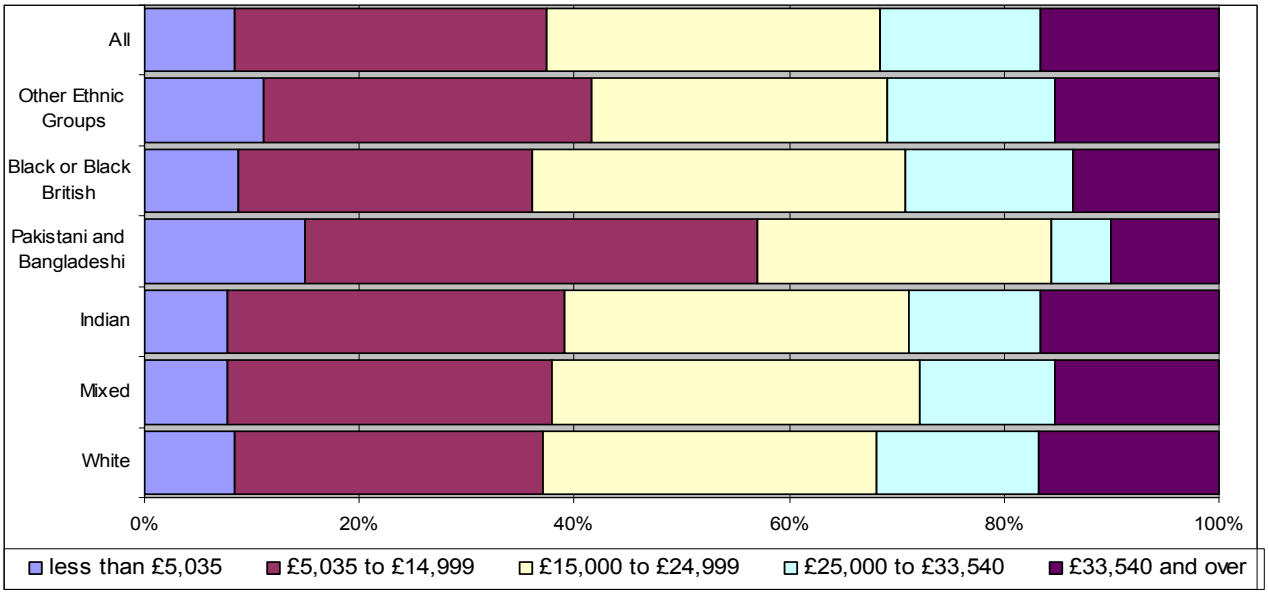
C.17 The Personal Accounts Delivery Authority will undertake an equality impact assessment which will set out how the personal accounts scheme will be designed and delivered to ensure that potential barriers to access arising from race, gender and disability have been properly considered and where required adjustments made.

Annex D: Race impact assessment

D.1 Minority ethnic groups are less likely to be saving for their retirement due to a combination of labour market patterns and the kinds of behavioural and informational barriers discussed in Chapter 1. Therefore reforms to work place pensions will affect employees in these groups proportionately more than all employees. This is because at these groups are over-represented in the target group for automatic enrolment

D.2 The employment rate varies slightly between minority ethnic groups. Pakistani and Bangladeshi have the lowest employment rate and are more likely to work part-time. [238] This is reflected in the earnings distribution. Figure D.1 shows that this group are slightly more likely to be lower earners, but overall employees from all ethnic groups are equally represented in the population of moderate to low earners (£5,035 to £33,540).

Figure D.1 Distribution of employees by earnings and ethnic group



Source: UK Family Resources Survey, 2003/04, 2004/05, and 2005/06

Note. Analysis based on employees aged 22 to State Pension age

D.3 All minority ethnic groups are slightly less likely to be contributing to a private pension than white individuals. Table D.1 shows the variation amongst employees across all ethnic groups. The participation rates are particularly low for Pakistani and Bangladeshi and Other Ethnic Groups. This is because Pakistani and Bangladeshi groups are more likely to be working part-time while those in the Other Ethnic Groups category are slightly more likely to be working in smaller firms, two groups that are not currently well served by the pensions market. The participation rates are marginally higher for Black or Black British groups who are slightly more likely to be working full-time or in the public sector where workplace pension membership is higher.[239]

Table D.1 Proportion of employees saving for a pension by earnings and ethnic group (%)

	less than £5,035	£5,035 to £14,999	£15,000 to £24,999	£25,000 to £33,540	£33,540 and over
White	23	44	64	77	85
Mixed	12	34	49	63	81
Indian	18	31	55	60	71
Pakistani and Bangladeshi	6	11	36	54	76
Black or Black British	9	28	51	62	79
Other Ethnic Groups	8	20	42	58	65
All	**22**	**42**	**63**	**76**	**84**

Source: UK Family Resources Survey, 2003/04, 2004/05, and 2005/06. Analysis based on employees aged 22 to State Pension age

D.4 Automatic enrolment will tackle the problem of inertia and lack of confidence in making financial decisions, which have had a significant effect on participation rates for people from minority ethnic groups[240]. Overall these reforms will give employees from all minority ethnic groups a substantial opportunity to build up private pension savings.

D.5 The staged implementation approach will have a slightly adverse effect on some minority ethnic groups, as these are more likely to work in smaller firms and therefore be staged in later.[241] Employees of minority ethnic groups are also more likely to have career breaks and will therefore have less time to build up their saving.[242] This is because the contributions foregone represent a larger proportion of their potential savings.

D.6 The Personal Accounts Delivery Authority will undertake an equality impact assessment which will set out how the personal accounts scheme will be designed and delivered to ensure that potential barriers to access arising from race, gender and disability have been properly considered and where required adjustments made.

Annex E: Disability impact assessment

E.1 People with disabilities are a diverse group. There are major variations within the group of disabled people, depending on their impairments, and the severity of those impairments.[243] In addition, the data sources available use different definitions of disability.

E.2 Disabled people are significantly less likely to be in employment than those who are not disabled. Although there have been significant improvements in the employment rates of disabled people in the last decade, 48 per cent of disabled people are in employment compared to 77 per cent of non disabled people.[244]

E.3 Table E.1 shows that, generally, employees who are disabled are equally represented in the target group of moderate to low earners (£5,035 to £33,540).

Table E.1: Distribution of employees by earnings and disability status (%)

	less than £5,035	£5,035 to £14,999	£15,000 to £24,999	£25,000 to £33,540	£33,540 and over
Not disabled	7	28	31	16	18
Disabled	11	32	30	14	13

Source: Family Resources Survey 2005/06

Note: In this analysis the definition for disability that we have used is 'people with a long-standing illness, disability or infirmity, and who have a significant difficulty with day-to-day activities'. This includes respondents who take some form of medication without which the health problems would significantly affect the respondents' life. This means that everyone in this group would meet the definition of disability in the Disability Discrimination Act (DDA); however, the estimates do not reflect the total number of people covered by the DDA as the Family Resources Survey does not collect this information fully. Analysis is based on employees aged 22 to State Pension age.

E.4 Thirty two per cent of disabled people are currently participating in a private pension, compared with 47 per cent of people who are not disabled. [245] However, the picture is different when only employed people are considered. Whilst disabled people are slightly more likely to be working part-time, overall employees who are disabled are just as likely as non-disabled employees to participate in a private pension, with 59 per cent of disabled employees contributing to a private pension, compared with 57 per cent of employees who are not disabled.[246] These figures reflect that disabled people are slightly more likely to work in the public sector where workplace pension membership is higher.[247]

E.5 Overall employees who are disabled are equally represented across all firms and do not have more broken work histories than average.[248] The implementation approach will therefore have the same effect on the pension saving of those who are disabled as the impact (discussed in Chapter 3) on all individuals saving under these reforms.

E.6 As with gender equality, trustees and managers of occupational pension schemes are required not to discriminate on grounds of disability (see section 4G of the Disability Discrimination Act 1995) and each such scheme must include a rule to this effect.

E.7 The Personal Accounts Delivery Authority will undertake an equality impact assessment which will set out how the personal accounts scheme will be designed and delivered to ensure that potential barriers to access arising from race, gender and disability have been properly considered and where required adjustments made.

Annex F: People benefiting from private pension reform - explanation of participation estimates

Background

F1. The workplace pension reform provisions aim to encourage and enable more people to save towards their retirement. This Annex presents analysis on the impact of the reforms on the number of people saving in a workplace pension scheme.

F2. From 2012, workers between the age of 22 and State Pension Age, with annual earnings in at least one job of more than £5,035 (2006/07 earnings terms) will be eligible for automatic enrolment into a qualifying pension scheme, unless they are already participating in such a scheme. It will be for the employer to choose the qualifying scheme into which they enrol their jobholders. The new personal accounts scheme will be one option open to employers and aims to complement existing workplace pension provision.

F3. This Annex sets out our current assumptions about what participation in workplace pension schemes will be after the reforms, particularly focusing on how our analysis and assumptions have changed since the previous participation estimates Annex, published in November 2007. This previous Annex was published alongside the Impact Assessment for the Pensions Bill 2007 (now the Pensions Act 2008) and explained how our participation estimates had changed between the May and December 2006 Regulatory Impact Assessments[249] and the 2007 Impact Assessment[250].

F4. Our current assumptions indicate that around 10–11 million[251] people will be eligible for automatic enrolment in a workplace pension scheme from 2012. This will lead to 5 to 9 million people newly saving or saving more in workplace pension schemes than before the reforms.

F5. Employers will be able to choose between enrolling eligible jobholders into either an existing form of workplace pension scheme or into the new personal accounts scheme, or a combination of both. We estimate that there will be 3 to 4 million more people saving or saving more in existing forms of workplace pension scheme, and 3 to 6 million people participating in the personal accounts scheme; this includes some who were previously saving in existing forms of workplace pension scheme, and some who opt in.

F6. There is inherent uncertainty around these figures. We can not be certain about how the pension and economic landscape may change in the years leading up to the reforms. And although our assumptions are informed by a programme of research, we can not be certain about how employers and individuals may change their behaviour in response to the reforms. This is why we have developed low, principal and high scenarios for all our trend and behavioural assumptions, and why figures in the Annex are generally presented as broad ranges. The analysis presented here

also assumes that all employers meet the requirements of the reforms, both to provide a workplace pension scheme, and automatically enrol their eligible employees into it.

F7. We will continue to monitor trends within the pension landscape and the economic context into which these reforms will be introduced, and so continue to improve our understanding of how the reforms will affect employers, individuals and the financial services industry.

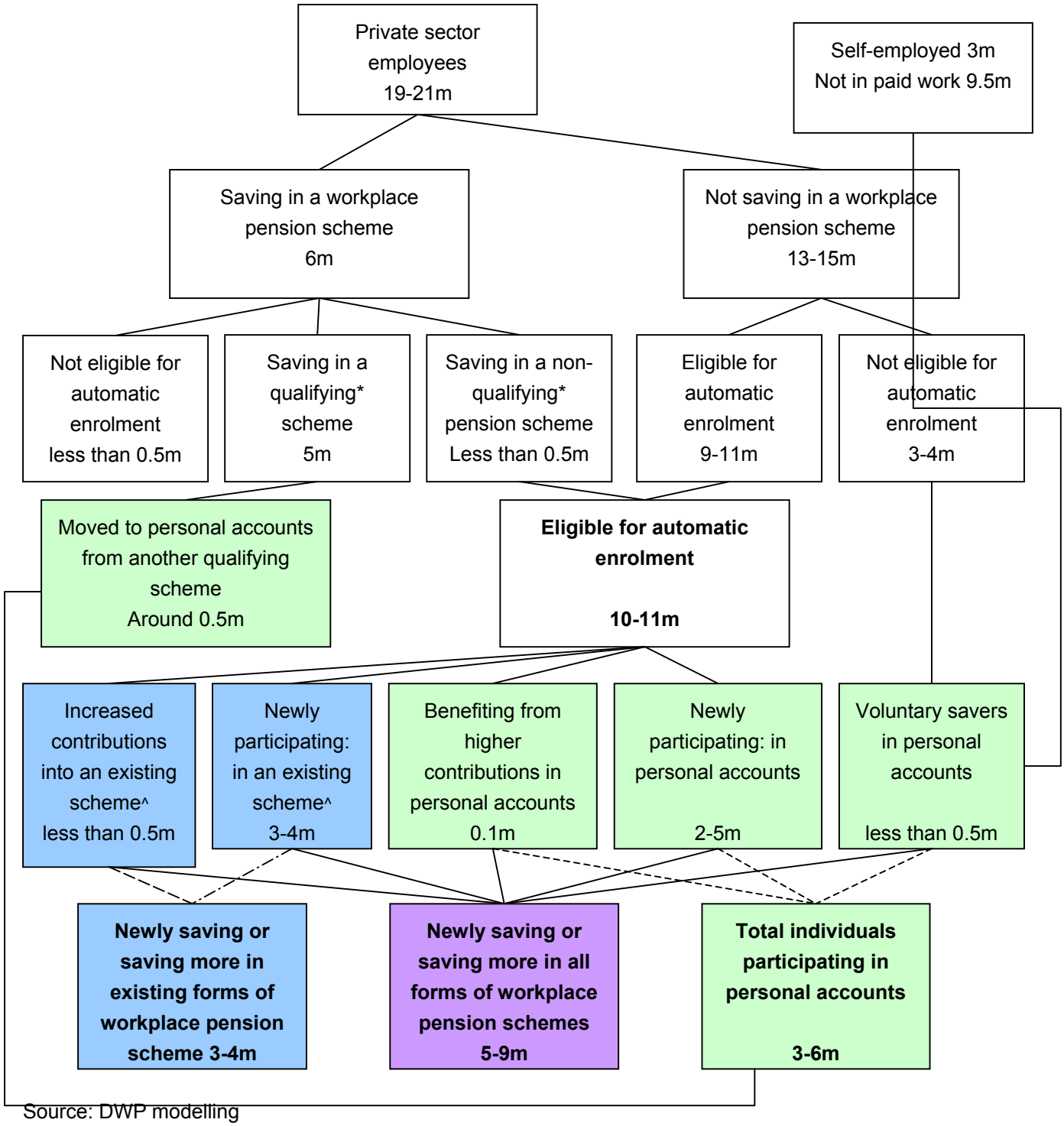
Headline Figures

F8. As a result of the reforms we expect there to be around 10 to 11 million people eligible for automatic enrolment into a workplace pension scheme. After accounting for people who opt out we expect this to result in:

- 5 to 9 million people newly saving or saving more in all forms of workplace pension scheme;
- 3 to 4 million people will be newly saving or saving more in existing forms of workplace pension scheme; and
- 3 to 6 million people saving in the personal accounts scheme, including some who were previously saving in existing forms of workplace pension scheme, and some who opt in.

F9. Figure 1 below sets out the range our estimates take for the number of people eligible for automatic enrolment, and the increase in number of people we expect to be participating in the personal accounts scheme or in other forms of workplace pension scheme after the reforms are introduced.

Figure 1: Estimates of number of people newly saving or saving more after the introduction of the reforms



Source: DWP modelling

Notes: Ranges are rounded to the nearest million, and therefore may not sum.

* Taking an employer contribution of at least 3 per cent into a current workplace pension scheme as a proxy for a defined contribution scheme that is likely to qualify under the Pensions Act 2008. We have assumed that all defined benefit schemes qualify in this analysis.

^ This is an existing or newly set up workplace pension scheme, other than the personal accounts scheme.

Assumptions underpinning participation estimates

F10. Our post-reform participation estimates are modelled in four key steps. First we model the current pension landscape in terms of employer provision of pension schemes and participation by employees. Second, we project this landscape forward to when the reforms will be implemented. Third, using evidence from research with employers we make assumptions about whether employers will use the new personal accounts scheme or existing or other provision to fulfil their duty to provide a qualifying pension scheme to their workers. Fourth, using evidence from research with eligible individuals we make assumptions about how many people will opt out of a scheme after being automatically enrolled by their employer. This section gives further information about each of these steps.

Current pension landscape

F11. Our estimate of the current pension landscape is derived from the Employers' Pension Provision (EPP) survey[252], weighted to the Small and Medium Enterprise (SME) statistics. Since the last time participation estimates were published the EPP and SME data used has been updated from the 2005 to the 2007 versions, and we have incorporated the non-profit sector into our analysis for the first time. The 2007 EPP survey shows that 21 per cent of 1.3 million employers already offered a pension scheme with an employer contribution of 3 per cent of pay. This means that around 79 per cent, or around 1 million employers were not offering a qualifying[253] pension scheme.

F12. We have also incorporated new data from the 2007 Annual Survey of Hours and Earnings (ASHE) to identify the number of people who would be eligible for automatic enrolment. Combining EPP and ASHE data we estimate that in 2007 around 36 per cent of the eligible population were already in qualifying pension schemes.

Projecting forward the 2007 landscape

F13. To understand the number of employers and employees that the pension reforms will affect when they are introduced, it is necessary to project forward the 2007 landscape as defined above. Since the last participation estimates were published we have updated our employment and employer projections, and our pension provision and membership projections.

Employment and employer projections

F14. Our projections of the overall private sector employed population are based on the actual growth figure for 2008; the summary of independent forecasts published monthly by HM Treasury for 2009 and 2010; and an assumption about long-term employment growth. This change in methodology has not changed our principal estimate that there will be 20 million private sector employees when the reforms are implemented, within a range of 19-21 million. We estimate that 16 million of these, within a range of 15-17 million, will be within the eligible group as defined by the Pensions Act 2008.

F15. We utilise information from the Office for National Statistics on the birth and death rates of enterprises from 2002-2007 to develop assumptions about how the number of employers may change. We estimate there will be up to 1.3 million employers with duties under the reforms when they are implemented.

Pension projections

F16. To project forward our 2007 estimates of the pension landscape we reviewed the available evidence on pension membership and provision to individuals, and scheme provision by employers. Our principal scenario assumes that trends in pension provision observed between 2003 and 2007 continue. We assume that the trends in employer provision of pension schemes are reflected in membership trends, with employers turning away from occupational schemes in favour of less expensive workplace pension schemes. In this scenario 34 per cent of the eligible population are in a qualifying pension scheme when the reforms are implemented, compared to 36 per cent in 2007.

F17. In our high scenario we assume that employers start to increase the quality of their pension provision in anticipation of the reforms, and consequently pension membership in qualifying pension schemes is slightly higher than in the principal scenario, at 36 per cent before the reforms take place. In our low scenario we assume that there is a more rapid trend away from occupational schemes and towards other workplace pension schemes, and consequently lower pension membership than in our principal scenario. In this scenario we estimate 32 per cent of the eligible population are saving in a qualifying pension scheme before the reforms take place.

F18. Using these projections, our assumption is that between 10 and 11 million workers will be eligible for automatic enrolment when the reforms are introduced. This compares to our previous assumption that between 9 and 11 million workers would be eligible for automatic enrolment. These totals include around 0.5 million people who we expect to be receiving an employer contribution of less than 3 per cent.

Employers' choice of pension scheme

F19. Employers can choose what sort of scheme they use to fulfil their new duties. We make assumptions to determine whether an employer chooses to place some or all of their employees into an existing form of workplace pension scheme, or into the new personal accounts scheme. It is likely that employers will make this decision separately for existing employees who are pension scheme members, existing employees who are not pension scheme members, and new employees.

F20. Our previous assumptions about employer choice were based on the Department of Work and Pension's Employers' Attitudes Survey (EAS)[254] carried out in 2007. Our current assumption uses more recent results from research commissioned by the Personal Accounts Delivery Authority (PADA). The Employer Decision-Making (EDM)[255] research was carried out between December 2008 and January 2009 and

contains responses from 3,000 employers about the choices they might make and the advice they may seek. The survey also has responses from 400 accountants, Independent Financial Advisors (IFAs) and Employee Benefit Consultants (EBCs) about the advice they are likely to offer employers.

F21. Based on the findings of this research we have been able to refine and develop our assumptions about whether an employer will choose to enrol some or all of their employees into the personal accounts scheme, or into an existing form of workplace pension scheme when the reforms are implemented. This is primarily through an assessment of the likely influence of intermediary advice on employers' choice of scheme, and a better understanding of how many employees may be enrolled into the personal accounts scheme by employers offering multiple pension provision. We now expect between 40 and 55 per cent of all those newly automatically enrolled into a workplace pension scheme to be enrolled into the personal accounts scheme.

F22. We estimate that 0.9-1.2 million employers will use the personal accounts scheme for at least some of their employees, and this will result in 5-6 million employees being automatically enrolled into an existing form of workplace pension scheme, and 4-7 million being automatically enrolled into the personal accounts scheme.

Opt-out by individuals

F23. Although all eligible employees will be automatically enrolled into a qualifying pension scheme, participation is not compulsory. Employees will have the opportunity to opt-out. Our estimate of the proportion of those automatically enrolled who will opt-out has not changed from that described in the Annex published in November 2007.

F24. To estimate the number of individuals who will opt out we use evidence from the Individuals' Attitudes Survey (IAS)[256] carried out in 2007. Using the responses to this survey, and taking account of the age distribution of those in the group eligible for automatic enrolment and making assumptions about the possible behaviours of those who were not certain what they would do, we estimate an opt out rate of around 25 per cent, within a range of around 20 and 45 per cent. We also assume that all those who are already saving in a pension scheme will continue to do so even if automatically enrolled into the new personal accounts scheme.

Other savers in the personal accounts scheme

F25. Individuals must meet the eligibility criteria in order to be automatically enrolled into a workplace pension scheme. If individuals do not meet these criteria then they might choose to voluntarily enrol into a pension scheme. Our estimates of the number of people who, although not eligible for automatic enrolment, might opt in specifically to the personal accounts scheme is unchanged from those described in the previous Annex published in November 2007. These assumptions use information about the number of employees (and current participation rates) of those aged less than 22, the self employed, the inactive (who can continue to save once they have a personal account), the unemployed, and those earning less than £5k.

Overall, we estimate that less than 0.5 million people will voluntarily opt in to the personal accounts scheme.

F26. Our estimates of how participation in workplace pension schemes will increase as a result of the current reforms have changed since those published in the Impact Assessments accompanying the introduction of the Pensions Bill 2007. The most important change is that we expect more people to save in existing forms of workplace pension arrangement, rather than in the personal accounts scheme.

F27. We will continue to update these participation estimates as we approach the implementation of the reforms, and as new evidence and data become available.

Annex G: Estimates of the employer administrative costs of reform

Background

G.1 In the Pensions Bill Impact Assessment published in April 2008, the Government presented estimates of the administrative costs of workplace pension reform to employers. The total administrative cost to employers of automatic enrolment and contribution collection by firm size was estimated to be £350 million in the first year and £101 million per year thereafter on an ongoing basis. Table G.1 shows a breakdown of these estimated costs by firm size.

Table G.1: Total estimated additional administrative and compliance costs to all firms of running either a new or an existing qualifying scheme[257]

	Cost in Year 1 (£ million)	Ongoing annual cost in future years (£ million)
Large firms	37	6
Medium firms	34	6
Small firms	105	28
Micro firms	167	59
Single person director firms (firms with no employees)	8	2
Total costs	**350**	**101**

Source: DWP modelling
Note: Costs are expressed in 2007/08 prices;

G.2 These estimates were the result of a cross-Government working group which refined the estimates of the cost impacts for employers presented in the December 2006 White Paper *Personal Accounts: a new way to save*.[258] The working group comprised of economists from the Department of Work and Pensions, the Enterprise Directorate at the Department for Business, Enterprise and Regulatory Reform (BERR), and the Better Regulation Executive. The working group:

- systematically reviewed all of the assumptions underlying the estimates;
- incorporated evidence from the latest data sources including the Annual Survey of Hours and Earnings and evidence from a Department of Work and Pension's survey of employer attitudes and likely responses to reform[259]; and
- commissioned two new research projects on the costs to employers:
  - a series of focus groups with employers of different sizes to help validate our estimates of the cost of internally administering monthly contributions.[260] This

research found the estimates to be broadly accurate and, if anything, slightly high; and

- a small telephone-based survey to help establish the additional costs of administering monthly contributions to employers who currently outsource their payroll functions.[261]

G.3 The remainder of this annex presents the latest estimates of the administrative costs to employers and explains the methodology and key assumptions that underpin them.

New administrative cost estimates

G.4 Table G.2 sets out the current estimates of the total administrative costs to firms of the processes required under the employer duties by firm size. A breakdown of the cost of each of these processes, by firm size, can be found in Tables G.8 and G.9 in the appendix to this annex.

G.5 The estimated total cost to employers is around one-quarter higher in the first year of introduction (£443 million) and in future years (£130 million)[262] compared with the estimates presented in the April 2008 Pensions Bill Impact Assessment. An explanation of the differences is discussed in this Annex.

Table G.2: Total estimated additional administrative and compliance costs to all firms of running either a new scheme or an existing scheme[263]

	Cost in Year 1 (£ million)	Ongoing annual cost in future years (£ million)
Large firms	82	13
Medium firms	50	10
Small firms	138	41
Micro firms	173	66
Total costs	**443**	**130**

Source: DWP modelling.
Note: Costs are expressed in 2009/10 prices.

Methodology

G.6 This analysis takes account of the range of processes and functions that employers will need to carry out in order to comply with their new obligations. These can be categorised as four discrete processes:

Process 1: preparing for start-up which includes:

- Investigating whether existing schemes meet the quality criteria;
- Decision makers meeting to discuss changes to business strategy due to the reforms;
- Making an arrangement with a pension scheme so that employees can be enrolled from the automatic enrolment date;
- Adapting or purchasing in-house or internal payment systems;
- Training staff to carry out the administrative processes;
- Communicating with all employees about the firm's response to the reforms.

Process 2: registration which includes:

- Receiving written confirmation from the Pensions Regulator about the firm's automatic enrolment date twelve and three months before that date;
- Registering for the PAYE service with the Government Gateway if payroll is outsourced;
- Registering with the Pensions Regulator each PAYE scheme giving details of the pension scheme(s) used to comply with the duties;
- Re-registering once every three years, verifying the details of the pension scheme(s) being used.

Process 3: enrolment activity which includes:

- Providing information to existing members of qualifying schemes;
- Providing information to jobholders whose automatic enrolment is being postponed;
- Enrolling eligible jobholders, providing them with the required information and providing their details to the pension scheme;
- Dealing with opt-outs and refunding any contributions deducted by the employer before the opt out was received;
- Providing information to jobholders not eligible for automatic enrolment and workers without qualifying earnings about their right to opt-in to pensions saving.

Process 4: collection and administration which includes:

- The calculation and collection of contributions from employees pay with effect from day one;
- Payment of contributions to the pension scheme;
- Dealing with queries about deductions;
- Processing requests to cease pension saving.

G.7 Each of the processes described above involves a number of tasks which the firm will need to carry out. The cost of each task is dependent upon:

- The time taken to carry out the task;
- The person carrying out the task and their hourly wage; and

- The number of workers in the firm who would be enrolled into a qualifying scheme.

Changes to the administrative cost estimates

G.8 Although our latest estimates appear to be broadly similar to those presented in the April 2008 Impact Assessment, there are a number of differences in the way we have estimated the different processes that employers might be expected to perform.

Number of firms

G.9 The numbers of firms and PAYE schemes who will be required to comply with the employer duties have been revised as set out in Annex F. Our assumptions about how firms will comply with their duties have been revised to take account of the Employer Decision Making Survey[264].

G.10 The Pensions Act 2008 now wholly excludes Worker-Director[265] firms from the employer duty implied by these regulations. Latest estimates suggest that this category could include up to 300,000 firms. This type of firm was included in the April 2008 estimates of administrative costs but has now been removed as there will be no administrative requirements on Worker-Director firms.

Wages

G.11 This analysis is based on median wage estimates from the Annual Survey of Hours and Earnings 2008, which have been uprated to 2009/10 earnings terms. Wages have been inflated by 21 per cent[266] to take account of non-wage costs, such as employer national insurance contributions, estate costs and IT costs. Analysis on dividend payments in the smallest firms has been incorporated to more accurately reflect the remuneration of the owner/manager in these firms.

Registration and re-registration

G.12 The requirement for all PAYE schemes to register with the Pensions Regulator and confirm their compliance with the employer duties has been included. All PAYE schemes will need to be registered with the Government Gateway in order to access registration. For those who outsource their payroll to a third party provider, it may be necessary to register for a new service before they will be able to access registration.

G.13 Firms will also be required to re-register with the Pensions Regulator every three years after automatic re-enrolment. This will involve updating the information provided at registration.

Enrolment activity

G.14 The estimates have been updated to take account of the latest estimates of the number of additional people saving after reform and where they might be saving, as set out in Annex F.

G.15 The one-off cost associated with supplying information to existing members of qualifying schemes has been included. The costs of supplying information to workers and jobholders not eligible for automatic enrolment has been included, as has the cost of enrolling any individuals who decide to opt-in.

G.16 The costs of the processes associated with automatic enrolment, opt-outs and refunds have been updated to reflect the policy detail that is now set out in the regulations.

G.17 The ongoing costs now include estimates of the costs of automatic re-enrolment of individuals who opted out or cancelled more than 12 months previously.

Collection and administration

G.18 HMRC analysis[267] has been used to estimate the time taken to fulfil employer duties. Research by Durham Business School[268] considered the time taken to carry out the monthly collection process for firms of different sizes. The research reported that the majority of respondents thought our estimates were appropriate if not a little high.

G.19 The estimates reflect HMRC information on the proportion of employers who are likely to outsource their monthly payroll obligations. Research by Middlesex University[269] examined the costs of additional obligations for firms who outsource their payroll systems. The results of their telephone survey suggest that additional costs to employers that already outsource their existing payroll obligations would be minimal due to the automated nature of the processes.

Costs to employers according to how they fulfil their new duties

G.20 Total administrative cost to firms that are likely to use existing schemes to fulfil their automatic enrolment duties is lower than the estimated cost to firms that are likely to use a new scheme. This is illustrated in Table G.3 and in the case studies in Box 4.2 in chapter 4. This is because the firms that choose to use an existing qualifying scheme are likely to already have a scheme in place and as such avoid the costs of setting up new systems.

G.21 It is assumed that for an employer not currently involved in pension provision, there is little difference between the minimum administrative costs of setting up and operating the personal accounts scheme compared to setting up an alternative qualifying scheme.

Average costs per firm

G.22 Tables G.4 and G.5 show the average administrative cost faced by firms using a new or existing qualifying scheme to fulfil their employer duties.

Table G.3: Estimated Employer costs, broken down by those using a new scheme and an existing scheme (£ million)				
	New Scheme		Existing scheme	
	Costs in Year 1	Ongoing costs in future years	Costs in Year 1	Ongoing costs in future years
Large firms	49	7	33	6
Medium firms	36	6	14	4
Small firms	122	35	16	6
Micro firms	167	64	6	2
Total costs	**374**	**112**	**69**	**18**

Source: DWP modelling

- Figures are expressed in 2009/10 prices;
- Figures are rounded to the nearest £1m and may not sum due to rounding.

G.23 As explained above, firms using an existing scheme are likely to face lower additional costs relative to firms using a new scheme. This is because firms with an existing pension scheme will have the advantage of having the necessary systems and processes already in place and knowledge of what providing a pension involves. While this is immediately obvious for medium, small and micro firms, it seems that costs per firm are greater for large firms using an existing qualifying scheme compared with those setting up a new scheme. This is simply a function of the number of individuals being enrolled into the scheme compared with the number of firms.

Table G.4: Estimated average administrative cost by firm size for a firm offering a new scheme			
	Number of firms	Cost in Year 1 (£)	Ongoing cost in future years (£)
Large firms	4,000	11,700	1,710
Medium firms	17,000	2,200	400
Small firms	318,000	400	100
Micro firms	747,000	200	90
All firms	**1,086,000***	**300†**	**100†**

Source: DWP modelling

Notes: Figures are expressed in 2009/10 prices; Figures are rounded to the nearest £100, where the figure is less than £100 it is rounded to the nearest £10 and may not sum due to rounding.

*total number of projected firms in 2012; †average administrative cost

Table G.5: Estimated average employer administrative cost for a firm offering an existing scheme			
	Number of firms	Cost in Year 1 (£)	Ongoing cost in future years (£)
Large firms	3,000	12,500	2,200
Medium firms	11,000	1,300	300
Small firms	67,000	200	100
Micro firms	57,000	100	50
All firms	**138,000***	**500†**	**100†**

Source: DWP modelling
Notes: Figures are expressed in 2009/10 prices; Figures are rounded to the nearest £100, where the figure is less than £100 it is rounded to the nearest £10; and may not sum due to rounding.
*total number of projected firms in 2012; †average administrative cost

G.24 Tables G.4, G.5, G.6 and G.7 show that while the average per firm cost is greatest for the largest firms, per employee costs are estimated to be much smaller. This reflects the fact that most small firms do not already provide a pension with an employer contribution and so will need to enrol a larger proportion of their workforce into a pension scheme. The greater scale of large firms also allows them to spread the fixed costs associated with these reforms across a larger number of employees.

Table G.6: Estimated employer administrative cost per employee by firm size for a firm offering a new scheme (£)			
	Number of individuals eligible for automatic enrolment	Cost in Year 1 (£)	Ongoing cost in future years (£)
Large firms	2,400,000	20	5
Medium firms	900,000	40	10
Small firms	2,300,000	50	20
Micro firms	1,400,000	120	50
All firms	**7,100,000***	**50†**	**20†**

Source: DWP modelling
Notes: Figures are expressed in 2009/10 prices; Figures are rounded to the nearest £100, where the figure is less than £100 it is rounded to the nearest £10 or £5 as appropriate and may not sum due to rounding.
*total number of automatic enrolments; †average administrative cost

Table G.7: Estimated employer administrative cost per employee by firm size for a firm offering an existing scheme (£)			
	Number of individuals eligible for automatic enrolment	Cost in Year 1 (£)	Ongoing cost in future years (£)
Large firms	2,000,000	20	5
Medium firms	800,000	20	5
Small firms	900,000	20	10
Micro firms	100,000	60	20
All firms	**3,800,000***	**20†**	**5†**

Source: DWP modelling
Notes: Figures are expressed in 2009/10 prices; Figures are rounded to the nearest £100, where the figure is less than £100 it is rounded to the nearest £10 or £5 as appropriate; and may not sum due to rounding.
*total number of automatic enrolments; †average administrative cost

G.25 The Government will continue to monitor trends in pension provision, the economic context in which these reforms will be introduced and gather evidence on the attitudes of employers, to the reforms. The programme intends to fully evaluate the effects of the reforms. The evaluation will assess the impacts of the reforms on employers, to evaluate the extent to which the policy objective is met whilst putting minimal burden on employers and maintaining current good pension provision.

Appendix G1: Employer administrative costs by process and firm size

Table G.8: Annual estimated employer administrative costs in Year 1 by process and firm size (£ million)

	Large	Medium	Small	Micro
Process 1: Prepare for start-up	**£36.3**	**£30.4**	**£78.7**	**£94.5**
Investigating whether existing schemes meet the quality criteria	1.5	4.1	6.9	2.7
Decision makers meeting to discuss changes to business strategy due to the reforms	0.1	0.4	5.5	15.4
Making an arrangement with a pension scheme so that employees can be enrolled from the automatic enrolment date	0.1	0.4	5.4	13.4
Adapting or purchasing in-house or internal payment systems	8.0	13.2	19.5	5.1
Training staff to carry out the administrative processes	2.1	3.9	30.9	46.4
Communicating with all employees about the firm's response to the reforms.	24.5	8.5	10.6	11.6
Process 2: Registration	**£0.1**	**£0.6**	**£4.0**	**£11.7**
Receiving written confirmation from the Pensions Regulator about the firm's automatic enrolment date (twelve and three months before that date at implementation).	0.0	0.1	1.4	3.8
Registering for the PAYE service with the Government Gateway	0.0	0.0	0.5	2.3
Registering with the Pensions Regulator each PAYE scheme giving details of the pension scheme(s) used to comply with the duties	0.1	0.4	2.1	5.7
Re-registering once every three years, verifying the details of the pension scheme(s) being used	-	-	-	-
Process 3: Enrolment activity	**£41.0**	**£12.5**	**£23.2**	**£13.7**
Providing information to existing members of qualifying schemes	10.8	2.2	1.7	0.2
Providing information to jobholders whose automatic enrolment is being postponed	0.4	0.2	0.3	0.1
Providing information to jobholders not eligible for automatic enrolment and workers without qualifying earnings about their right to opt-in to pensions saving.	5.6	1.3	2.6	0.9
Enrolling eligible jobholders, providing them with the required information and providing their details to the pension scheme	19.5	7.1	15.0	8.5
Dealing with opt-outs and refunding any contributions deducted by the employer before the opt out was received	4.6	1.8	3.6	4.1
Automatic re-enrolment, including opt-outs and refunds	-	-	-	-
Process 4: Collection and Administration	**£4.7**	**£6.8**	**£32.0**	**£52.7**
Calculation and collection of contributions from employees pay	3.6	5.6	21.2	39.2
Payment of contributions to the pension scheme	0.3	0.9	10.2	12.9
Dealing with queries about deductions and processing requests to cease pension saving.	0.9	0.4	0.6	0.6
Total Costs	**82.2**	**50.3**	**137.9**	**172.7**

Source: DWP modelling Note: Costs are expressed in 2009/10 prices

Table G.9: Annual estimated employer administrative costs in future years by process and firm size (£ million)				
	Large	**Medium**	**Small**	**Micro**
Prepare for start-up	**0.0**	**0.1**	**2.5**	**7.5**
Investigating whether existing schemes meet the quality criteria	-	-	-	-
Decision makers meeting to discuss changes to business strategy due to the reforms	-	-	-	-
Making an arrangement with a pension scheme so that employees can be enrolled from the automatic enrolment date	0.0	0.0	0.3	1.6
Adapting or purchasing in-house or internal payment systems	-	-	-	-
Training staff to carry out the administrative processes	0.0	0.1	2.1	6.0
Communicating with all employees about the firm's response to the reforms.	-	-	-	-
Registration	**0.0**	**0.1**	**0.5**	**1.8**
Receiving written confirmation from the Pensions Regulator about the firm's automatic enrolment date (twelve and three months before that date at implementation).	0.0	0.0	0.0	0.2
Registering for the PAYE service with the Government Gateway	-	-	-	-
Registering with the Pensions Regulator each PAYE scheme giving details of the pension scheme(s) used to comply with the duties	0.0	0.0	0.1	0.7
Re-registering once every three years, verifying the details of the pension scheme(s) being used	0.0	0.1	0.3	0.9
Enrolment activity	**8.1**	**3.0**	**6.1**	**4.0**
Providing information to existing members of qualifying schemes	-	-	-	-
Providing information to jobholders whose automatic enrolment is being postponed	0.1	0.0	0.1	0.0
Providing information to jobholders not eligible for automatic enrolment and workers without qualifying earnings about their right to opt-in to pensions saving.	1.0	0.2	0.5	0.2
Enrolling eligible jobholders, providing them with the required information and providing their details to the pension scheme	4.1	1.7	3.3	1.8
Dealing with opt-outs and refunding any contributions deducted by the employer before the opt out was received	0.9	0.4	0.7	0.8
Automatic re-enrolment, including opt-outs and refunds	2.0	0.7	1.5	1.3
Collection and Administration	**4.7**	**6.8**	**32.0**	**52.7**
Calculation and collection of contributions from employees pay	3.6	5.6	21.2	39.2
Payment of contributions to the pension scheme	0.3	0.9	10.2	12.9
Dealing with queries about deductions and processing requests to cease pension saving.	0.9	0.4	0.6	0.6
Total Costs	**12.9**	**10.0**	**41.0**	**66.1**

Source: DWP modelling
Note: Costs are expressed in 2009/10 prices

Annex H: Social Welfare Estimates: explanation of the methodology and assumptions

Background

H.1 The value of pensions can be measured in two different ways. The simplest way to quantify this value is to consider it as an investment - money contributed to a pension fund which grows over time, depending on the performance of the underlying assets. The fund is then withdrawn in the form of an annuity at the point of retirement. There are many tools available to evaluate this type of investment, such as net present value (discussed below) or internal rate of return.

H.2 Pensions also have value as a tool for 'consumption-smoothing' or transferring consumption from a period in someone's life where they can afford to consume a lot to one where they can afford to consume only a little. Even if the amount they set aside during working life does not grow, it can be argued that an individuals' welfare is increased by this process. This increase in welfare is more difficult to quantify.

H.3 The approach taken in our analysis is based on the DWP technical paper[270] refined to take onboard the uncertainty surrounding some of the assumptions. The methodology effectively addresses the two 'values' of pension saving. The investment aspect of pensions is evaluated using a net present value statistic, which is then weighted to capture the value of consumption smoothing. To gain insight into the aggregate concept of social welfare, analysing individual welfare or utility is a useful approach. Whilst utility is not identical to happiness, research suggests that the two concepts are closely related. The analysis estimates social welfare by aggregating the welfare of all individuals in society. The evaluation is presented in monetary terms but is in fact a monetary equivalent: the increase in social well-being resulting from the pension reforms is evaluated in terms of how much it would cost to generate the same levels of well-being (or happiness) by simply giving people money.

Methodology

H.4 The basic outline of the method is to calculate the net present value of a £1 investment in a pension fund for individuals of various ages and incomes and at various points from the start of the pension reform up to 2050. This net present value is then weighted, using a simple utility function and benchmark replacement rates to capture the value of consumption smoothing, generating a weighted net present value for each age and income group. This is then multiplied by the number of people expected to be saving and the contributions they will be making (8 per cent of qualifying earnings).

H.5 The theory of the marginal utility of consumption underpins the weighting and is used to compare the proportion of working income given up with the corresponding increase in retirement income.[271] The central assumption in economics literature is

that the marginal utility of consumption diminishes as consumption increases. This is why individuals with different income levels have different levels of marginal utility. The marginal utility of consumption is equal to the inverse of consumption, so if consumption halves, the marginal utility of consumption doubles. It is this function that is used to derive the weighting applied to the net present value, which will capture the value of consumption smoothing.

H.6 Replacement rates, the ratio of retirement income to income while working, is another key component of the weighting function. Although individuals seek to spread their income over their lives, evidence suggests that they do not seek to fully replace their income while in retirement. This is because people face lower expenditure once they retire: they no longer face work related costs, they may have paid off their mortgage, and they no longer pay pension or national insurance contributions. The Pensions Commission provides replacement rates that people should aspire to in order to maintain a similar standard of living in retirement as in their working life. These benchmark rates have been confirmed by survey evidence which asked individuals about their desired income in retirement.[272] This is different to the minimum replacement rate they proposed for a median earner.[273]

H.7 To illustrate how we arrive at the weighted net present value, take an individual earning £20,000 in working life and receiving £10,000 in retirement based on state pension alone. Assume that this hypothetical individual gives up £1 in working life and receives £1 in retirement.[274] Assuming diminishing marginal utility gives a utility function of the form:

$$U = \log(C)$$

which, in turn implies that the marginal utility (taking the first derivative of the utility function) of consumption is given by:

$$\delta U / \delta C = 1 / C$$

$$U_F = 1 / 20{,}000$$ [275]

$$U_G = 1 / 10{,}000$$ [276]

$$= 2.U_F$$

H.8 So in this simple example, the utility gained in retirement is twice as much as the utility foregone in working life. We would therefore weight the net present value of this £1 investment by multiplying it by 2. However, due to the fact that individuals do not need to fully replace their income in retirement to achieve the same standard of living, we use the benchmark replacement rate for a median earner as 67 per cent based on the Pensions commission analysis, and take this fraction to derive the new weighting factor:

$$W = 0.67 \times 2$$

$$= 1.34$$

H.9 The first and last pound that an individual contributes to a pension will have different consumption-smoothing implications. The first pound saved will give the highest value and the last pound the smallest value to the individual, so each contribution should in principle be weighted more heavily than those that follow it. In practice, we use the average of these high and low weightings associated with the first and last pound contributions to generate our estimates. The high weight is given by the benchmark replacement rate divided by the replacement rate in the absence of private savings; the low weight is given by the benchmark replacement rate divided by the replacement rate of someone who saves 8 per cent of their qualifying earnings in a pension fund for the rest of their life.

Assumptions

H.10 The social welfare effect of around £40 to 60 billion for the period up to 2050 is based on programme assumptions of the number of individuals who will opt-out of pension saving. These are estimated to be 25 per cent with a range of around 20 and 45 per cent will opt out. The lower bound of the range is calculated using high opt-out rates (lower volumes of people saving) and the upper bound using low opt-out rates (higher volumes of people saving). Annex F provides further details on participation estimates.

H.11 A number of other key assumptions are made in the model. It is assumed in the model that bonds average an annual growth rate of 1.5 per cent (after adjusting for inflation) and equities grow at 5 per cent (after inflation). By default, 80 per cent of the fund value is invested in equities and 20 per cent in bonds until the last 10 years before retirement, after which point the equities are gradually swapped for bonds. The discount rate, which is used in calculating the net present value of the investment, is chosen in line with HMT Green Book recommendations (3.5 per cent for the first 30 years of an investment and 3.0 per cent thereafter).

Annex I: Estimates of costs and benefits - assumptions and methodology

I.1 Details of the methodology and assumptions underpinning our estimates of the numbers of savers and employer administrative costs are contained in Annex F and G respectively. This annex provides an explanation of any additional assumptions and methodology used to calculate the costs and benefits in this impact assessment.

Assumptions

I.2 The assumptions underpinning our analysis are consistent with HM Treasury's economic assumptions used in the Budget 2009 Financial Statement and the Budget Report. Other main assumptions are as follows:

Population projections

I.3 The demographic projections used in this impact assessment are based on data produced by the Population Division of the Office for National Statistics (ONS) Centre for Demography.

I.4 Estimates are based on the latest (2006-based) population projections for the United Kingdom and constituent countries, published in October 2007.

Inflation

I.5 The Bank of England is assumed to meet its 2 per cent inflation target for the Consumer Prices Index (CPI) on average. All other inflation assumptions (such as the Retail Price Index) are determined relative to this CPI baseline. Any differences between the two result from different coverage and methodology used in calculating the different measures.

I.6 House prices are assumed to rise in the long term in line with earnings.

Productivity and earnings growth

I.7 Productivity is assumed to increase at 2 per cent per year over the medium term. It is assumed that real earnings growth follows productivity growth. Thus, it is implicitly assumed that there is no change in the labour share of overall GDP. Real GDP growth is the combination of employment and productivity growth.

Methodology

Modelling of outcomes for individuals

I.8 Since the publication of the 2008 Pensions Bill Impact Assessment, the DWP has updated its modelling of hypothetical individuals, which we use to estimate future

income in retirement and replacement rates. This will mean some of these figures will not be comparable with those published in the April 2008 Bill Impact Assessment.

I.9 Updates to the modelling included in this publication include:

- Incorporation of policy changes announced in the 2009 Budget and 2008 Pre-Budget Report.
- Improved private pension modelling assumptions, including fund growth, non-compliance and participation rates in the personal accounts scheme.
- Incorporating new mortality equations.

I.10 The results are, of course, illustrative and dependent on assumptions about factors such as investment growth.

Estimates of future pensioner incomes using Pensim2

I.11 Pensim2 is a dynamic micro-simulation model that has been developed in DWP to inform analysis of likely future trends in pensioner incomes. Pensim2 builds up a picture of the future pensioner population by modelling future life events and work histories for a representative sample of individuals.

I.12 The model currently starts from a set of base data representative of the GB household population in 2001. This base data includes detailed information on the characteristics of individuals and their employment and pension histories to date. For each subsequent year, sets of equations are used to model, for each individual, the probability of certain events occurring, based on estimates from current data. The calculated probabilities are then used within the model to determine what happens to each individual in a given year.

I.13 The individual labour market and pension histories generated by the model are used to calculate estimates of pensioner incomes in each year of the simulation.

I.14 The methodology and equations underlying Pensim2 have been validated by the Institute for Fiscal Studies. Their findings and recommendations for further development were published in a working paper in 2004. This is available on their website.[277] Results from Pensim2 have been validated by comparing a range of key outputs against trends in latest administrative and survey data and the projections produced using other modelling approaches.

I.15 Pensim2 is particularly well-suited to long-term projections of expenditure on income-related benefits, where the distribution of future pensioner incomes is a key determinant of entitlement and expenditure. Pensim2 models the future accrual of pensions by individuals, based on their projected labour market status each year.

I.16 All models are constantly reviewed and refined. The latest version of Pensim2, which was used to generate the analysis contained in this document, has been improved since publication of the Pensions Bill Impact Assessment 2008. Major developments include accounting for the latest population projections from ONS and

revising behavioural assumptions using recent DWP research evidence[278], private pension assumptions and changes to trivial commutation rules.

Annex J: Glossary

Active membership	The definition will be in accordance with individual scheme rules. Each scheme will have a defining action that will create active membership for a member. For personal pensions active membership will be achieved once the contract is deemed (see deeming the contract below). For the purposes of re-enrolment active membership is defined by regulation 14(4).
Automatic enrolment	Employers will be required to make arrangements by which eligible jobholders become active members of an automatic enrolment scheme with effect from the automatic employment date. Automatic enrolment is not applicable if the jobholder is an active member of a qualifying scheme on that date.
Automatic enrolment date	The automatic enrolment date will be the start date of the joining window, which also becomes the effective date of active membership, once the joining process has been completed. The automatic enrolment date will be determined by: • The employer's staging date during implementation; • The first day on which the jobholder starts work and meets the eligibility criteria (post implementation); and • Meeting the jobholder criteria whilst in work by either: - reaching age 22 (in receipt of qualifying earnings); - having qualifying earnings for the first time (aged 22 to pensionable age).
Automatic enrolment scheme	A qualifying scheme where the rules have no restrictions on membership and does not require the jobholder to express a choice or provide information in order to become or remain an active member.
Automatic re-enrolment	Requires employers every three years from the employer's staging date to repeat the automatic enrolment process in respect of eligible jobholders who have opted out of pension saving during the one month opt out period or at any stage after the end of that period left pension saving. There are exceptions to the minimum three years.
Contract based schemes	A defined contribution pension scheme purchased by an individual, either through their employer or individually, from a pension provider. It is owned entirely by the individual with the contract existing between the individual and the pension provider. It is also known as a personal pension.

Compliance regime	A set of powers and processes exercisable by the Pensions Regulator, which have the ultimate goal of maximising compliance with the employer duties and employment safeguards set out in the Pensions Act 2008.
Common Commencement Dates (CCDs)	Bringing in new legislation affecting business in April and October of every year.
Continuity of scheme membership	Employers are required to maintain a jobholder's active membership of a qualifying scheme, while they are in that employment unless the jobholder chooses to end their membership.
Day one / Day one duties	See automatic enrolment date.
Defined benefit (DB) scheme	An occupational pension scheme under which all of the benefits that may be provided accrue at a defined rate and total benefits can be calculated in advance of drawdown.
Defined contribution (DC) scheme	Occupational or personal pension schemes where contributions made into the scheme are invested into one or more investment funds. Some times known as money purchase schemes (see the definition of money purchase schemes for more details).
Employers	Employer in relation to a worker, means the person by whom the worker is employed (see full definition in section 88 of Pensions Act 2008).
Employee representatives	A recognised independent trades union or body representing employees.
Family Unit	Comprises two generations of people; at least one dependent child and at least one adult who is responsible for this child.
Group Personal Pensions (GPP)	An arrangement made by employer for employees to participate in a personal pension arrangement. Each employee has an individual contract with the pension provider. Currently, the employer may or may not make a contribution on behalf of the employee. The employer may also pay the employee's contribution direct from his salary through direct payment arrangement.
Group Self Invested Personal Pension	A group personal pension where the contracts are SIPPs rather than personal pensions (see SIPP definition).

(GSIPP)	
Gross Domestic Product (GDP)	A measure of economic activity in a country. It is calculated by adding the total value of a country's annual output of goods and services.
Gross National Product (GNP)	A measure of economic activity. It is the value of all goods and services produced in a country in one year, plus income earned by its residents abroad, minus income payable to non-residents.
Hybrid schemes	A hybrid scheme has been defined as an occupational pension scheme that is not purely DB or purely DC.
Impact Assessment	Impact assessment is part of the policy making process that sets out the rationale for a proposed Government intervention of a regulatory nature and identifies the future economic and social consequences in the public, private and third sectors.
Implementation	Implementation refers to the staging and transitional arrangements following the launch of automatic enrolment, to help employers and the delivery authorities to adjust gradually to the reforms.
Jobholders	A worker who is working or ordinarily works in Great Britain under a contract of employment, who is aged at least 16 and under 75 and has gross earnings over £5,035 (in 2006/07 terms).
Large firm	For statistical purposes, the Department for Business, Innovation and Skill usually defines a large firm as one with 250 or more employees.
Long run	Long run effects are those that outlast any adjustment periods and persist even when the economy has re-balanced
Median	The median of a distribution divides it into two halves. Therefore half the group are above the median value and half below.
Medium firm	For statistical purposes, the Department for Business, Innovation and Skill usually defines a medium firm as one with between 50 and 249 employees.
Micro firm	For statistical purposes, the Department for Business, Innovation and Skill usually defines a micro firm as one with between 1 and 4 employees.
Money purchase	Benefits provided under a pension scheme, the rate or amount

scheme	of which is calculated by reference to an amount available for the provision of benefits to or in respect of the member. Sometimes referred as a defined contribution scheme.
Nineteen day rule	The prescribed period outlined in the Occupational Pension Schemes (Scheme Administration) Regulations 1996 and the Personal Pensions (Payments to Employers) Regulations 2000 that sets the due date for employee contributions deducted from salary to be paid over to the scheme. Currently this is nineteen days from the beginning of the month following deduction.
Non-UK pension scheme	A pension scheme, either DB, DC or hybrid that has its main administration somewhere other than in the UK.
Occupational pension scheme	A person scheme set up, usually under a trust by an employer for their staff. Can be defined benefit, hybrid or defined contribution person scheme set up in trust by an employer for their staff.
Opt-in	A new right under the Pensions Act 2008. A jobholder who is not eligible for automatic enrolment may by notice require the employer to arrange for them to become an active member of a scheme.
Opt-out	Once active membership has been achieved and the jobholder is in receipt of the enrolment information, the jobholder has a right to opt-out of active membership and will be treated as having never been a member of the scheme.
Opt-out period	A jobholder who has been automatically enrolled into a qualifying scheme may give notice to opt-out of membership within one month from the completion of the joining processes.
Pay As You Earn (PAYE)	A method of paying income tax. The taxpayer's employer deducts tax from their wages or occupational pension before paying these wages, and passes these contributions over to HMRC. In order to do this, the employer must have a PAYE scheme set up. Wages includes sick pay and maternity pay.
Pensions (Automatic Enrolment) Regulations 2009	The draft Pensions (Automatic Enrolment) Regulations set out the prescribed practical arrangements underpinning automatic enrolment, including information flows between employers, pension schemes and jobholders, the arrangements for postponement of automatic enrolment and the arrangements should a jobholder choose to opt out (including the refund rules). These have now been subsumed within the draft

	Occupational and Personal Pension Schemes (Automatic Enrolment) Regulations 2010.
Pensions Regulator (TPR)	UK regulator of work-based pension schemes.
Pensionable pay	The pay on which pension contributions are calculated.
Personal Accounts Delivery Authority (PADA)	The Personal Accounts Delivery Authority (PADA) is a non-departmental public body (NDPB) accountable to Parliament and reporting, through a Board, to the Secretary of State for the Department for Work and Pensions. It is responsible for setting up the national, trust-based pension referred to in this document scheme as the personal accounts scheme.
Personal Accounts (PA) scheme	A new simple, low-cost, defined contribution, occupational pension scheme to be established by the Secretary of State under section 67 of the Pensions Act 2008 which employers may choose to comply with their duty under the Act.
Personal Pension	A contractual arrangement between an individual and a pension provider (such as an insurance company) which enables the individual to make provision for a pension on a defined contribution basis.
Qualifying earnings	An earnings band of £5,035 to £33,540 per annum (in 2006/07 earnings terms), on which pensions contributions will be calculated for money purchase schemes. Earning qualifying earnings (i.e. above £5,035) is a criterion of jobholders and is a factor in determining whether a worker is to be automatically enrolled.
Qualifying schemes	Qualifying schemes are pension schemes that meet a minimum standard for the level of contributions made to the scheme or the level of benefit provided. There are different quality standards depending on whether the scheme is DB, DC, or hybrid.
Registration	The formal process by which employers will provide information to the Regulator about how they have met their enrolment duties.
Re-registration	The process of obtaining compliance information from employers every three years.
Record keeping	The creation and retention of records of activities undertaken by employers, the trustees and managers of occupational

	schemes and pension providers, in relation to the employer duties.
Self-invested Personal Pension (SIPP)	An arrangement which forms all or part of a personal pension scheme, which gives the member the power to direct specifically how some or all of the member's contributions are invested (as opposed to simply choosing a fund or funds).
Short run	The short run is the time it takes for the economy to adjust and stabilise following a change, such as a policy reform or the introduction of a new technology.

Small firm	For statistical purposes, the Department for Business, Innovation and Skill usually defines a small firm as one with 49 or fewer employees.
Staged approach / Staging	The employer duties will be implemented in stages over a period rather than from a single launch date.
Stakeholder Pension	Stakeholder pensions are a type of personal pension. They have to meet certain government standards on to ensure they are flexible and have a limit on annual management charges
Transitional arrangements: DC schemes	The gradual introduction of employer contribution costs. Employers will begin to be staged in October 2012, and will pay 1 per cent employer contributions from October 2012, 2 per cent from October 2016 and 3 per cent from October 2017 which will be steady state. Jobholders will pay 1 per cent from October 2012, 3 per cent from October 2015 and 5 per cent from October 2017 which includes tax relief. They may choose to contribute more, although employers will not be required to match any voluntary contributions.
Transitional period: DB schemes	The period in which defined benefit schemes (and hybrid schemes) are exempt from activating membership of existing members for a period prescribed in regulations Phasing contributions is not appropriate for defined benefit schemes, which must comply with minimum funding requirements at all times.
Trust based schemes	Trust-based pension An employer-sponsored pension scheme with the scheme taking the form of a trust arrangement (alternatively known as an occupational pension scheme). Benefits can be either DC or DB.
Worker	An individual who has entered into work under a contract of employment or any other contract by which the individual

	undertakes to do work or perform services personally for another party to the contract.
Worker without qualifying earnings	An individual who is ordinarily working in Great Britain under a contract, who is aged at least 16 and under 75 and has gross earnings less than £5,035 (in 2006/07 terms).
Workplace personal pension (WPP)	An umbrella term covering Group Personal Pensions, Group Self-Invested Personal Pensions and Stakeholder Pensions.