Title: Pensions Act – Workplace pension reform legislation	Impact Assessment (IA)
	IA No:
Lead department or agency: Department for Work and Pensions	**Date: 21/11/11**
	Stage: Final
Other departments or agencies: N/A	**Source of intervention:** Domestic
	Type of measure: Primary legislation

Summary: Intervention and Options

What is the problem under consideration? Why is government intervention necessary?

Millions of people in the UK are not saving enough for retirement. There are a number of barriers which prevent individuals from starting saving, which particularly affect low to moderate earners. Many people have low financial literacy and poor understanding of pensions and the benefits of saving. Where people understand the need to save, 'inertia' often means the decision is delayed 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 overarching objective of the reforms to workplace pensions, legislated for in the Pensions Act 2008, is to enable low to moderate earners to save more for retirement. The specific measures discussed in this Impact Assessment are designed to ease the burdens that employers face in complying with that legislation. The changes are designed to ease the burden on employers and industry, whilst maintaining the key aim of ensuring individuals are able to save for their retirement.

What policy options have been considered? Please justify preferred option (further details in Evidence Base)

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.

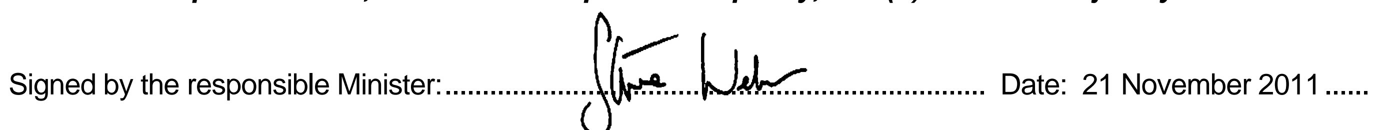
The Pensions Act 2008 then introduced a series of measures to increase private pension saving. This centred on the use of automatic enrolment, so that individuals would be put into a workplace pension scheme and have to take an active decision to opt out. Combined with a minimum employer contribution and the creation of a pension scheme which could be used by any employer, this is expected to lead to a step change in the level of participation in pension saving.

This particular Impact Assessment considers a range of options designed to make the automatic enrolment process work better and to reduce the burden that business will face. These options stem from an independent review of the programme that was carried out during summer 2010. That review incorporated a series of workshops and discussions with employers and their representatives, industry representatives and consumer groups as well as a call for written evidence. A fuller assessment of all the options and impacts is contained in the "Making automatic enrolment work" review report [http://www.dwp.gov.uk/docs/cp-oct10-full-document.pdf].

When will the policy be reviewed to establish its impact and the extent to which the policy objectives have been achieved?	It will be reviewed in 2017
Are there arrangements in place that will allow a systematic collection of monitoring information for future policy review?	Yes

Ministerial Sign-off For final proposal 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, benefits and impact of the policy, and (b) the benefits justify the costs.



Signed by the responsible Minister:.. Date: 21 November 2011 ......

Summary: Analysis and Evidence — Policy Option 1

Description: Making automatic enrolment work

Price Base Year 2011	PV Base Year 2011	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate:** 150

COSTS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Cost** (Present Value)
Low	Optional	1	Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0		610	11,020

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 (2011/2012) prices.
(costs shown include increases in earnings over and above the rate of inflation)

Transfers (Annual averages presented in Table 0.1)
Average reduction in individuals' savings into private pensions: £590m per year
Increase in Government expenditure on income-related benefits: £20m

Other key non-monetised costs by 'main affected groups'

The reduction in the amount saved changes the value of consumption smoothing. This amount does not represent a financial transfer but represents the perceived value to individuals from transferring income from more affluent times to retirement. The present value of this impact falls between a loss of £2 billion (4 per cent) and a gain of £1 billion (2 per cent), so a small loss of around 1 per cent on average

BENEFITS (£m)	**Total Transition** (Constant Price)	Years	**Average Annual** (excl. Transition) (Constant Price)	**Total Benefit** (Present Value)
Low	Optional	1	Optional	**Optional**
High	Optional		Optional	**Optional**
Best Estimate	0		620	11,180

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 (2011/2012) prices.
(benefits shown include increases in earnings over and above the rate of inflation)

Transfers (Annual averages presented in Table 0.1):
Reduction in employer contribution costs: £220m.
Reduction in individual contribution costs: £280m.
Increase in individual receipts of income-related benefits: £20m.
Decrease in Government tax relief on pension contributions: £90m.

Resource costs (Annual average presented in Table 0.2):
Reduction in employer administrative costs: £10m.

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

Key assumptions/sensitivities/risks — **Discount rate (%)** 3.5

The success of these reforms is sensitive to the behaviour of individuals and employers. The key assumptions are: individual participation rates, employer choice of qualifying scheme and employer pension contributions following reform, and mechanism for dealing with costs of reforms. The outcomes of pension saving for individuals are dependent on returns to investment.

Impact on admin burden (AB) (£m) 2005/6 terms:			**Impact on policy cost savings (£m):**	**In Scope**
New AB:	**AB savings:** 3	**Net:** -3	**Policy cost savings:** N/A	Yes

Enforcement, Implementation and Wider Impacts

What is the geographic coverage of the policy/option?			United Kingdom		
From what date will the policy be implemented?			October 2012		
Which organisation(s) will enforce the policy?			Department for Work and Pensions, The Pensions Regulator		
What is the annual change in enforcement cost (£m)?			Commercial (contracted)		
Does enforcement comply with Hampton principles?			Yes		
Does implementation go beyond minimum EU requirements?			N/A		
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	
Does the proposal have an impact on competition?			No		
What proportion (%) of Total PV costs/benefits is directly attributable to primary legislation, if applicable?			**Costs:** 100	**Benefits:** 100	
Annual cost (£) per organisation (excl. Transition) (Constant Price)	**Micro** -£50	**< 20** /	**Small** -£150	**Medium** - £790	**Large** -£9,290
Are any of these organisations exempt?	No	No	No	No	No

Specific Impact Tests: Checklist

Does your policy option/proposal have an impact on…?	**Impact**	**Page ref within IA**
Statutory equality duties[1] Statutory Equality Duties Impact Test guidance	Yes	Annexes D - F
Economic impacts		
Competition Competition Assessment Impact Test guidance	Yes	Annex C
Small firms Small Firms Impact Test guidance	Yes	Annex B
Environmental impacts		
Greenhouse gas assessment Greenhouse Gas Assessment Impact Test guidance	No	
Wider environmental issues Wider Environmental Issues Impact Test guidance	No	
Social impacts		
Health and well-being Health and Well-being Impact Test guidance	No	
Human rights Human Rights Impact Test guidance	No	
Justice system Justice Impact Test guidance	No	
Rural proofing Rural Proofing Impact Test guidance	No	
Sustainable development Sustainable Development Impact Test guidance	No	

[1] Race, disability and gender Impact Assessments are statutory requirements for relevant policies. Equality statutory requirements will be expanded in 2011, once the Equality Bill comes into force. Statutory equality duties part of the Equality Bill apply to Great Britain only. The Toolkit provides advice on statutory equality duties for public authorities with a remit in Northern Ireland.

Evidence Base (for summary sheets) – Notes

References

Include the links to relevant legislation and publications, such as public Impact Assessment of earlier stages (e.g. Consultation, Final, Enactment).

No.	Legislation or publication
	Pensions Bill Impact Assessment – April 2008
	Impact Assessment: (Automatic Enrolment) Regulations – March 2009
	Impact Assessment: consultation stage – Workplace Pension Reform (Completing the Picture) Regulations 2009
	Workplace Pension Reform Regulations: Impact Assessment – January 2010

Annex 1: Post Implementation Review (PIR) Plan

Basis of the review:

The Department has made a commitment to fully evaluate the effects of the reforms and how they are delivered. In addition, the Pensions Act 2008 specifies that there will be a review of the National Employment Savings Trust (NEST), including those features that are designed to focus it on the target market, including 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.

Review objective:

The evaluation will be a proportionate check that the regulations are operating as expected and to ensure that there are no unintended consequences for individuals, employers or industry as a result of the reforms. Longer term evaluation will be against the policy objective of getting more people to save more for their retirement.

Review approach and rationale:

There will be an ongoing evaluation using a range of data such as management information from NEST and The Pensions Regulator (TPR), stakeholder discussions, existing continuous surveys of individuals and employers and where appropriate, research commissioned by the Department. Where possible, key statistics to be drawn from ongoing large surveys such as the Office for National Statistics Annual Survey of Hours and Earnings to ensure continuity of data availability.

Baseline:

Pre-reform (2011 or early 2012 depending on the data source being considered).

Success criteria:

Success will be measured against the policy objective of getting more people to save more for their retirement. This objective should be achieved in a way that represents value for money for the taxpayer and puts minimal burden on employers whilst maintaining current good pension provision.

Monitoring information arrangements:

Plans for ongoing monitoring form part of the governance structures across the Department, NEST and The Pensions Regulator. The evaluation will be carried out on an ongoing basis to gauge progress through implementation of the reform and beyond.

Evidence Base (for summary sheets)

The following tables show the costs and benefits of the changes to the workplace pension reforms contained in the Pensions Bill, when compared to the eligibility criteria set out in the Pensions Act 2008. The baseline costs and benefits from which these changes are measured can be found in Annex A.

The tables present average annual changes over the 39 years to 2050, followed by the one off transitional cost and then the ongoing cost in 2012 (which, due to phasing and staging of the auto-enrolment policy, is small). Finally, changes every ten years are shown, with an increased effect in later years due to population and earnings growth.

Tables in this section present net benefits: an additional cost is a negative number, an additional benefit is a positive number.

Therefore:

- A decrease from the baseline in individual contribution costs is shown as a positive number.
- An increase from the baseline in income related benefits paid to individuals is shown as a positive number.
- A decrease from the baseline in overall savings into private pensions is shown as a negative number.
- An increase from the baseline in government expenditure on income-related benefits is shown as a negative number.

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

	Annual average	One-off cost (present value)	2012	2020	2030	2040	2050
Individuals							
a) Contribution costs	280	0	*	240	300	360	440
b) Receipt of income related benefits	20	0	*	10	20	30	40
c) Savings into private pensions	-590	0	*	-500	-610	-750	-910
Net benefit	**-280**	**0**	*****	**-250**	**-290**	**-350**	**-420**
Employers							
d) Contribution costs	220	0	*	190	230	280	340
Net benefit	**220**	**0**	*****	**190**	**230**	**280**	**340**
Government							
e) Contribution costs (income tax relief)	90	0	*	70	90	110	130
f) Income related benefit expenditure	-20	0	*	-10	-20	-30	-40
Net benefit	**60**	**0**	*****	**70**	**70**	**80**	**90**
Total							
Net Benefit	**0**	**0**	**0**	**0**	**0**	**0**	**0**

Notes:

- Costs cover the UK.
- Figures are expressed in 2011/2012 price terms; present values are 2011/2012-based.
- Costs shown include increases in earnings over and above the rate of inflation
- Figures are rounded to the nearest £10 million.
- The employer 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.
- Costs are presented as negative numbers, benefits as positive numbers.
- * means that small costs or benefits arise but are under £5 million. In 2012, costs are frequently small because relatively few individuals are automatically enrolled due to the implementation design.
- Higher savings into private pension is the sum of tax relief, employer contribution and individual contribution costs.

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. Table 0.1 shows the impact of the changes as set out in the Pensions Bill on income transfers for specific points in time through to 2050.

A three month waiting period and raising the earnings threshold from £5,035 (2006/07 terms) to £7,475 (2011/12 terms) result in some employees being excluded from automatic-enrolment, which leads to reduced overall contributions from employees and employers, reduced costs to the exchequer in the form of tax relief, and an increase in the cost of income related benefit expenditure.

a) Individual Contribution costs are the cash contributions made from individuals, i.e. not including tax relief.

b) Receipt of income-related benefits reflects the change in entitlement to income-related benefits in retirement caused by the fall in private pension saving.

c) Savings into private pensions are the sum of individual and employer contributions plus government tax relief. These estimates relate to the additional contributions made into pensions and not the private pension incomes individuals will receive as a result of this saving.

d) Employer contribution costs are the cash contributions made by employers if employers were to make the minimum employer contribution of 3 per cent for all eligible jobholders who do not opt-out.

e) Government contribution costs (tax relief) reflect changes to the costs to the Exchequer of tax relief on individuals' pension contributions.

f) Income-related benefit expenditure reflects the change in **expenditure** in income-related benefits described above.

Resource Costs

In addition to decreasing the costs of contributions from the employer, employers also benefit from reduced resource and administration costs. This is partly due to employers having fewer employees to automatically enrol and partly due to the greater flexibility employers have to undertake processes at a time that works best for them.

Table 0.2: Estimated resource costs arising from changes to workplace pension reform (£ million)

	Annual average	One-off cost (present value)	2012	2020	2030	2040	2050
g) Employer administrative costs	10	0	*	10	10	10	10
h) Cost of changing scheme rules	0	0	0	0	0	0	0
Net Benefit	**10**	**0**	*	10	10	10	10

Notes:

- Costs cover the UK.
- Figures are expressed in 2011/12 price terms; present values are 2011/12-based
- Costs shown include increases in earnings over and above the rate of inflation
- All figures rounded to the nearest £10 million.
- Costs are presented as negative numbers, benefits as positive numbers.
- * indicates that small costs/benefits arise but are under £5 million.

g) Employer administrative costs reflect the change in the costs employers incur in administering participation in pension schemes.

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. We previously estimated the ongoing annual administrative burden of the Pensions Act 2008 and associated regulations to be £99 million. As a result of the changes to the workplace pension reforms contained in the Pensions Bill, the summary sheet shows a reduction in this burden of £3 million[2].

h) Cost of changing scheme rules relates to the cost of reviewing the rules and making required changes to all open workplace pension schemes in the run up to the reform.

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 as a result of greater consumption-smoothing. This non-

[2] Administrative burdens are expressed in 2005/6 terms.

monetised benefit takes into account distributional impacts, with the weighting taking account the relative prosperity of those receiving the benefit.

Currently, we estimate a social welfare benefit of £40 to £60 billion up to 2050. The changes outlined in this Impact Assessment have a small impact on the value of consumption smoothing. The present value of this impact falls between a loss of £2 billion (4 per cent) and a gain of £1 billion (2 per cent), so a small loss of around 1 per cent on average. *This amount does not represent a financial transfer*, but represents the perceived value to individuals.

Excluding some lower earning individuals from automatic enrolment is estimated to increase the social welfare benefit slightly if you assume they have constant earnings throughout their lifetime. This is because lower earners receive high replacement rates from state provision alone, so contributing into a private pension during their working life could have a negative impact on consumption smoothing.

A waiting period affects all individuals across the income spectrum and has a greater effect on reducing the value of consumption smoothing.

- At one end of the spectrum, we assume all individuals earning below £7,475 either opt into pension saving or become eligible for automatic enrolment (due to income movements over the year). This would generate no change from the baseline estimate of social welfare benefit. We also assume all employers operate a three month waiting period, and all individuals eligible for automatic enrolment do not opt in during these three months. This generates a social welfare "loss", equivalent to around £2 billion (4 per cent).
- At the other end, we assume no employers use the waiting period. This would generate no change from the baseline estimate of social welfare benefit. We also assume no individuals earning below £7,475 become eligible for automatic enrolment or opt in to pension saving during their working life. This generates a social welfare "gain", equivalent to around £1 billion (2 per cent).

Our best estimate is that the real outcome will be somewhere in between these two scenarios. We know that around half of employers who currently provide a pension operate a waiting period. We also know that, while individuals earning less than £7,475 are unlikely to opt in, evidence suggests[3] that lower earners are likely to move around the income scale throughout the year, and therefore could be automatically enrolled.

Table 0.3: Estimated resource benefits arising from changes to 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	Between a loss of £2 and a gain of £1	Between a loss of £2 and a gain of £1
Net Benefit	0	Between a loss of £2 and a gain of £1	Between a loss of £2 and a gain of £1

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 2012-2050, and are presented in 2011/12 prices.
- Costs are rounded to the nearest billion.

Figures presented in this evidence base are consistent with the Better Regulation Executive guidelines.[4] Costs are in 2011/12 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.

[3] Hills, J, Smithies, R, McKnight, A, *Tracking Income; How working Families' incomes vary through the year',* ESRC Research Centre for Analysis of Social Exclusion, CASE report 32
[4] See: http://bre.berr.gov.uk/regulation/ria/

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Section 1: Overview and summary of costs and benefits

Background and objectives for reform

1.1 The legislative changes set out in the Pensions Act 2008 and Workplace Pension Reform Regulations 2010 aim to increase private pension saving in the UK. They form part of a wider pensions reform package designed to ensure that the UK has a pension system that enables individuals to save towards achieving the lifestyle they aspire to in retirement.

1.2 This Impact Assessment accompanies the Pensions Bill 2011, which will focus on a number of changes to the pension system. This includes a number of policies that are intended both to finalise details of the workplace pension reform policy, and also to implement the policy recommendations made by the independent "Making automatic enrolment work" review in 2010[5].

The need for reform

1.3 The Pensions Commission was set up in 2002 to assess how the pension system was developing over time and to make recommendations on whether the pension system should move beyond a purely voluntary approach.

1.4 The Commission concluded that whilst pensioner income levels are on average high by historical standards, the existing system of private funded pensions combined with the current state system will deliver increasingly inadequate and unequal results. The report concluded that millions of people are not saving enough to meet their retirement aspirations, with DWP analysis putting this figure at around seven million.

1.5 There are a number of barriers to saving, even where people recognise that it is in their best interests to do so. Specifically:

- A limited understanding, amongst many people, of pensions and the benefits of saving for retirement.
- A tendency to procrastinate. Evidence shows that even where people make commitments to saving, they put off acting on that decision, suggesting hyperbolic (rather than even) discounting of consumption.
- The power of inertia. People often accept the situation as it is, or choose the course of action which requires least decision-making. People who start saving usually keep saving, often at the same contribution rate. People who are not saving usually continue not saving. Pension schemes in which the default option is for new employees to join produce much higher pension participation than if an active decision to join has to be registered.
- Difficulty in accessing pension provision. There is an ongoing decline in the provision of pension schemes offered by employers and relatively poor market provision for many on moderate to low incomes and those who work for small firms.

1.6 The Commission explored three solutions to the problem of undersaving, namely: a major revitalisation of the voluntary system and/or; significant changes to the state system; and/or an increased level of compulsory private pension saving beyond that already implicit within the UK system.

[5] Johnson P, Yeandle D and Boulding A, 2010, *Making automatic enrolment work – a review for the Department for Work and Pensions,* Parliamentary Command Paper Cm 7954

1.7 They concluded that the problems are not solvable through changes to the state system alone, nor by incremental measures to encourage voluntary saving. At the same time, compulsion with respect to private pension saving presents risks of forcing some people to over-save, and does not accommodate diversity in people's preferences for different ways to save (e.g. through housing assets).

1.8 The Commission recommended a solution whereby the state strongly encourages people to achieve a minimum level of private pension provision, whilst enabling them to save more in a cost-efficient way. The suggestion was for a minimum *replacement-rate*[6] of 45 per cent for the average median earner. Overall, this means increasing both the number of people saving in pensions and the amounts saved.

To achieve this objective, the Commission recommended:

- The creation of a National Pension Savings Scheme (NPSS).
- All employees not already covered by a good quality pension scheme should be automatically enrolled into this NPSS.
- Individual contributions should be matched by modest compulsory employer contributions, to ensure that the scheme offers attractive returns, and to level the playing field between employers who do and do not already offer pension provision.

1.9 These recommendations were broadly accepted by the Government of the time and commanded a widespread political consensus. Since 2006 the DWP has been working to develop the detail of this policy, to put in place the legislative framework to prepare for implementing the proposals in 2012.

The policy set out in the Pensions Act 2008 and associated regulations broadly followed the Pensions Commission's recommendations, as follows:

- Employers will be required to automatically enrol their eligible jobholders into a pension scheme meeting minimum quality requirements.
- Minimum contributions of eight per cent on a band of earnings must be paid in respect of the member, of which at least three per cent must come from the employer.
- NEST, a trust-based occupational pension scheme will be set up with a public service obligation to accept any employer (and qualifying worker) that wishes to use the scheme.

1.10 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 scheme. Regulations were consulted on in 2009, and a set of regulations were laid in Parliament in January 2010, with an accompanying Impact Assessment.

1.11 This Impact Assessment, accompanies the Pensions Bill, andbuilds on the analysis presented in the previous Impact Assessments. The estimates presented will be different to those presented in earlier Impact Assessments to reflect the latest evidence and research where available.

Building consensus around the policy

1.12 It is essential that there is a stable and long-lasting system of pension saving in the UK, so that decisions taken by savers today are not undermined by changes to the system tomorrow. The Government has therefore worked hard to build a broad-based consensus

[6] A replacement-rate measures income in retirement as a percentage of income before retirement

among the public, businesses, the pensions industry and across political parties, to ensure that the private pension reforms stand the test of time.

1.13 Following Royal Assent for the Pensions Act 2008, in March 2009 the Government consulted on draft regulations covering the automatic enrolment process. In April 2009 they further consulted on the draft scheme order and rules for NEST (then called the "personal accounts scheme"). In September 2009 the Government consulted on a second batch of draft regulations, to implement and enforce the reforms. Alongside this written consultation, DWP held a number of seminars to discuss the regulations with a range of stakeholders, and also conducted formal research into employers' views on the policy details.

1.14 As a result of the March 2009 consultation on draft regulations, significant changes were made to the automatic enrolment process, including: extending the joining window; simplifying timescales and information requirements; amending the 19 day rule in order to minimise burdens associated with refunds. These changes are discussed in detail in the Government response to that consultation.[7] No significant changes were made to the Scheme order and rules for NEST, since respondents broadly agreed to the proposals.

1.15 A number of relatively minor changes were made in response to the consultation on the second batch of regulations in September 2009. The most significant amendment was removing certification from the regulations, in response to strongly held stakeholder views that DWP needed to return to the drawing board on this policy.

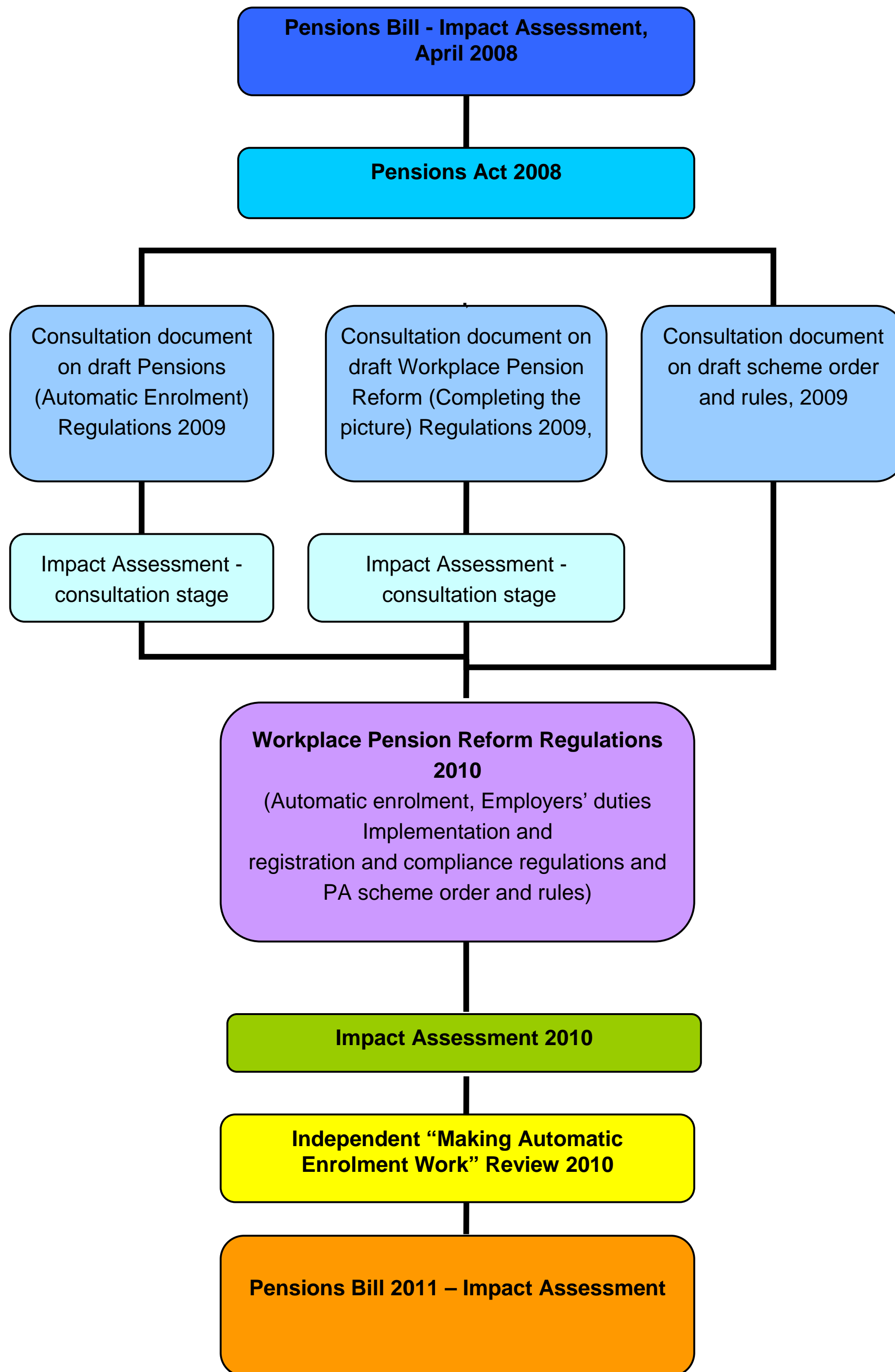
1.16 In autumn 2009 the DWP reconsidered the implementation plans for automatic enrolment, in light of changing economic circumstances. The Government's key objective is to get the infrastructure in place as quickly as possible, whilst ensuring that the reforms are implemented in an operationally achievable way that is also manageable and sustainable for employers and individuals. DWP therefore adjusted the implementation plan to allow small employers and new businesses more time before being staged into the duties.

1.17 In 2010 an external review team was commissioned to re-examine the policy behind automatic enrolment, and as part of this process undertook an in-depth consultation on the scope of the reforms and potential options for amending the policy. The external review team received 73 written responses to their formal call for evidence, along side gathering views at a number of seminars and one to one meetings. All this evidence was carefully considered, and the recommendations of the review broadly reflect stakeholders' views.

Figure 1.1 summarises the consultations and documents surrounding the private pension reforms that have been published since the introduction of the Pensions Act 2008.

[7] DWP, 2009, The Pensions (Automatic Enrolment) Regulations 2009: Government Response to the Consultation on Regulations

Figure 1.1: Sequence and coverage of workplace pension reform legislation and consultation



The "Making automatic enrolment work" review

1.18 In June 2010 the new Coalition Government commissioned an independent review into the best way to support the introduction of automatic enrolment into private pension saving. The review was intended to build on the work of the Pensions Commission by examining the policy in light of certain changes that had taken place since the original recommendations, namely:

- The credit crunch in financial markets, the economic downturn and the fiscal deficit.
- A greater understanding of likely costs and the proposed charging structure for NEST.
- The proposed approach and profile for introducing the new employer duties and phasing in of minimum levels of mandatory contributions.
- The proposed review of state pension age.
- Other changes such as the further increases in life expectancy and further decline in private sector pension coverage.

1.19 The review team were asked to consider whether the proposed scope for automatic enrolment strikes an appropriate balance between the costs and benefits to both individuals and employers, or whether the underlying policy objective of increasing private pension savings would be better delivered by a different scope for automatic enrolment. The team were keenly focused on options for reducing unnecessary burdens on business, and examining the impacts for key groups, particularly women.

1.20 The team were also asked to assess the capacity of the existing pensions market to meet the demand created by automatic enrolment, and thus whether the policy of establishing NEST is the most effective way to guarantee universal access to workplace pension saving and income security in retirement.

1.21 In examining the evidence and formulating potential options for change the review team sought to consult with as many interested parties as possible, through meetings with key individuals and three wider seminars with representatives of consumers, employers and industry. The review also issued a formal call for evidence.

Appendix 1: Summary of impacts and burdens

Changes to Pension Regulation:	Impact on Individuals:	Impact on Employers:	Impact on Industry:	Impact on Government/ Exchequer	Regulatory burden on business
Introduction of a waiting period of up to three months, with opt in during that three months	Reduces the number of individuals automatically enrolled by up to 0.5 million. Reduces accumulated savings by up to three years on average - if all employers operate the maximum waiting period.	Reduces costs for employers. Annual saving on administration of at least £3 million, and an estimated saving of £150 million in contribution costs. Relatively larger impact for small and micro employers.	Reduces costs for providers. Fewer small pots to administer and improved persistency of pensions saving.	Reduces Exchequer costs. Saves an estimated £60 million in tax relief, and £40 million in foregone tax revenue, annually.	Reduces burden for employers and industry.
Increase Earnings Thresholds	Reduces the number of individuals automatically enrolled by up to 0.6 million. Persistent low earners will already get high replacement-rates from the state pension system.	Reduces costs for employers. Employers will need to enrol slightly fewer individuals. Avoids employers having to process very small pensions contributions. Estimated savings on employer contributions are £30 million. Estimated savings on administration costs are £3 million. Relatively larger impact on savings for	Reduces costs for providers. Providers administer fewer small pots of pensions than under the previously planned reforms.	Reduces Exchequer costs. Saving of £10 million each on tax relief and tax revenues foregone.	Reduces burden for employers and industry.

Changes to Pension Regulation:	Impact on Individuals:	Impact on Employers:	Impact on Industry:	Impact on Government/ Exchequer	Regulatory burden on business
		micro employers.			
Introduce greater flexibility around re-enrolment	Negligible. Whilst certain individuals could be re-enrolled slightly more or less frequently, the average impact should be minimal.	Reduces costs for employers. Greater flexibility will allow employers to undertake re-enrolment at a time that works best for them.	Negligible impact.	Negligible impact.	Reduces burdens for employers.
Certification - simplified 3-stage test	Minimal impact. Slight risk that some individuals could receive less than the level of contributions currently set out in legislation.	Reduces costs for employers. Allows employers to easily use existing good quality schemes. A simplified test makes it easier for employers to ensure they are compliant with the minimum contribution requirements.	Beneficial. It will be easier for employers to continue using existing pension scheme arrangements.	Negligible impact.	Provides an easement for employers which should also benefit the pensions industry.
Flagging: TPR will ensure that micro employers know that NEST has been designed to meet their needs	Beneficial. Making the process more straightforward for the smallest employers should improve compliance levels. That will improve the number of individuals who are automatically enrolled into a pension	Reduces costs, particularly for micro employers. Flagging will help micro employers in making a choice about which qualifying scheme to use. It should therefore reduce the burdens of making that	Negligible impact. The industry currently does not serve the segment of the market which will benefit from flagging.	Negligible impact.	Reduces the burden that micro employers face in choosing a qualifying pension scheme.

Changes to Pension Regulation:	Impact on Individuals:	Impact on Employers:	Impact on Industry:	Impact on Government/ Exchequer	Regulatory burden on business
	scheme	choice.			
Miscellaneous set of corrective amendments	Negligible.	Negligible.	Negligible.	Negligible.	Negligible.
Overall	The package of changes which the Pensions Bill proposes in relation to the Workplace Pension Reforms is deregulatory in nature. They reduce costs for employers by £170 million a year in contributions, and £6 million* a year in ongoing administrative costs. Exchequer costs will also fall: average annual tax relief will fall by around £70 million and foregone tax revenue will fall by £40 million.				

Note: Unless otherwise stated, the figures presented in this table are provided as steady state levels in 2011/12 earnings terms.

Section 2: Impacts of specific changes to the legislation

2.1 This section sets out changes to the legislation proposed within the Pensions Bill and considers the impacts for the key groups of interest. In assessing the impact of these changes, we have assumed that employers make full use of the flexibility offered.

Changes to the earnings threshold for eligibility for automatic enrolment and the qualifying earnings band

2.2 Under the Pensions Act 2008, employers will be required to automatically enrol certain jobholders who earn more than £5,035 a year (in 2006/07 terms)[8] into qualifying pension arrangements. If the individual chooses not to opt out of pension saving, the employer must pay contributions based on a band of earnings between £5,035 and £33,540. The qualifying earnings threshold acts both as a trigger for automatic enrolment and as the threshold for contributions to start accruing.

Why consider change?

2.3 The primary reason for considering changes to the earnings threshold for automatic enrolment is that there may be individuals who are consistently lower earners and find that the State, through pensions and benefits, provides them with a sufficiently high replacement rate without additional saving. For these individuals it may not be beneficial to redirect income during working life into pension saving. The Pensions Commission used the concept of the replacement rate to measure the proportion of working-age income that is 'replaced' by income in retirement.

2.4 The second reason for change is to re-align thresholds with other current earnings triggers – such as the National Insurance and tax thresholds.

Stakeholder views

2.5 As already discussed, as part of the "Making Automatic Enrolment Work" review stakeholders were consulted on the current shape of the legislation. There were mixed views on the earnings level at which individuals should be automatically enrolled. Industry, employer and consumer groups all expressed concern that the current policy included some low earners for whom it might not be worthwhile saving. Many thought there was a case for increasing the threshold at which an individual would be automatically enrolled, though there were different views on what level it should be.

2.6 Stakeholders were clear, however, that while it may be appropriate to raise the threshold for automatic enrolment, the levels of earnings from which contributions are calculated once an individual is enrolled should not be increased.

2.7 Consumer representatives generally supported as broad a scope for automatic enrolment as possible and wanted to ensure that key groups (especially women) were included. However, they had some concerns about the affordability of pension saving for lower earners, and that the interaction with income-related benefits may reduce returns for some groups. There were different views on the policy implications of this dilemma – some felt it justified a small increase in the earnings threshold, whilst others believed there was no case for change because individuals are already able to opt out of pension saving.

[8] £5,841 in 2011/12 earnings

2.8 Employers supported a slight increase in the earnings threshold. This was predominantly driven by concerns about what they perceived as an unnecessary administrative burden, which they felt could be removed if the pension thresholds matched thresholds in the National Insurance system.

2.9 The strongest support for increasing the earnings threshold came from industry representatives, with many suggesting that £10,000 was an appropriate threshold. Others suggested that the earnings threshold(s) could be linked to National Insurance thresholds; tax thresholds; or National Minimum Wage levels.

Which options were considered?

2.10 Options examined by the review team for the threshold at which an individual becomes eligible for automatic enrolment were:

- The National Insurance primary threshold – a small change, realigning the automatic enrolment threshold with the National Insurance primary threshold of £5,824 in 2011/12 earnings terms (£5,715 in 2010/11);
- Raising the threshold slightly, aligning it with the threshold for income tax, removing some of the lowest earners from the scope of automatic enrolment. The Government has announced a real increase in this threshold to £7,475 in 2011/12 earnings terms (£7,336 in 2010/11);
- Move toward the Government aspiration for future income tax thresholds – removing a more significant proportion of lower earners from automatic enrolment - £10,190 in 2011/12 earnings terms (£10,000 in 2010/11);
- Setting a level above full-time work at the National Minimum Wage – to test the impact of removing a significant proportion of lower earners from automatic enrolment £14,266 in 2011/12 earnings terms (£14,000 in 2010/11).

Option chosen

2.11 The earnings threshold should be increased to £7,475, in 2011/12 earnings terms so that it is aligned with the threshold for income tax. Individual contributions should be deducted from the National Insurance primary threshold of £5,824 (in 2011/12 earnings terms). This ensures that individuals who are automatically enrolled have their pension contributions calculated on a significant portion of their income. Those individuals who are no longer automatically enrolled will still have the right to opt in if they wish.

Impact on individuals

2.12 A low earnings threshold creates a risk that individuals are automatically enrolled into pension savings when they are unlikely to benefit from that saving (they already get a high replacement rate from the State). A high earnings threshold creates a risk that individuals are not automatically enrolled when they are likely to benefit from saving.

2.13 Table 2.1 shows that increasing the earnings threshold to £7,475 will reduce the number of individuals who are automatically enrolled by up to 0.6 million. Women would then make up 38 per cent of the group eligible to be automatically enrolled, compared with 40 per cent under the current policy. All of the individuals no longer automatically enrolled as a result of the increase in the automatic enrolment earnings trigger may, however, still opt in to pension saving and receive an employer contribution. See Gender Impacts at Annex D for further detail.

Table 2.1: Impact on individuals of different qualifying earnings

Eligibility for Automatic Enrolment 2010/11 (2011/2012)	Individuals		
	Total coverage	% female	Other characteristics
Current target group	10-11m	40%	12% BME 12% disabled
£7,336 (£7,475)	-0.6m	78% (of the 0.6m) 38% in revised overall target group	No particular impacts by ethnicity, disability or age group. No disadvantage as individuals retain the right to opt in
£10,000 (£10,190)	-1.4m	76% (of the 1.4m) 36% in revised overall target group	
£14,000 (£14,266)	-2.9m	68% (of the 2.9 m) 32% in revised overall target group	

Source: Department for Work and Pensions modelling
Annual Survey of Hours and Earnings, Great Britain 2009, Office for National Statistics

2.14 As already discussed, persistent low earners see a high replacement rate from the existing state pension system. Whilst this might lead us to conclude that there is a justification for a significantly higher threshold for automatic enrolment than is set out in the Pensions Act 2008, there are several considerations which militate against such a conclusion.

2.15 Firstly, receipt of benefits or tax credits provides a big incentive for many low earners to save in pensions; all of an individual's contribution to a private pension scheme is disregarded from their income when calculating entitlement to tax credits, and half is disregarded when calculating entitlement for other income-related benefits.

2.16 In addition, most low earners go on to earn more, and only through saving year on year can they accumulate a pot of reasonable value. More importantly, in the real world it makes little sense to look at individual replacement rates. Most individuals live in households with others and many very low earners are women living with men who earn rather more. It may well be desirable for them to be accumulating a pension pot of their own.

2.17 The separation of the eligibility threshold from the contribution threshold creates a small de minimis amount of contributions, avoiding the situation whereby individuals make tiny pension contributions. This should result in a reduction in the number of very small pots which are proportionately more expensive for providers to administer and therefore could help to keep charges lower and therefore improve outcomes for individuals. However, it also creates a potential "cliff edge", where small increases in earnings (such as through a pay rise) could tip individuals over into making significant pension contributions, reducing their take home pay. Analysis suggests that this impact should be minimal.[9]

Impact on employers

2.18 The administrative and contribution cost savings with each alternative earnings threshold is presented in Table 2.2.

[9]Johnson P, Yeandle D, and Boulding A, 2010, *Making automatic enrolment work – a review for the Department for Work and Pensions,* Parliamentary Command Paper Cm 7954, p 199

2.19 Reducing the number of individuals automatically enrolled as a result of increasing the automatic enrolment threshold leads to both administrative and contribution cost savings. Separating the earnings threshold from the lower earnings limit reduces the administrative costs associated with those individuals who repeatedly start and then stop making contributions because of fluctuating earnings.

2.20 The changes specified in the Pensions Bill result in an annual reduction in contribution costs of £30 million and ongoing administrative costs of £3 million.

Table 2.2: Impact on employers of different qualifying earnings

Eligibility for Automatic Enrolment 2010/11 (2011/2012)	Employer savings	
	Contribution costs (m)	Administration costs (m)
Current target group	£3,510m	£458m year 1 £132m ongoing
NICs Primary Threshold	No change	No change
£7,336 (£7,475)	-£30m	-£5m in year one -£3m in ongoing years
£10,000 (£10,190)	-£70m	-£9m in Year 1 -£6m in ongoing years
£14,000 (£14,266)	-£280m	-£18m in Year 1 -£13m in ongoing years

Source: Department for Work and Pensions modelling
Notes:
- Values are steady-state costs in 2011/12 earnings terms
- Contribution costs are rounded to the nearest £10 million, administrative costs are rounded to the nearest £1 million.

2.21 Table 2.3 shows that micro firms tend to benefit most from reduced administrative and contribution costs as they are more likely to employ low earners - around two thirds of individuals who work for micro firms earn less than £15,000, compared with around a third of individuals who work for employers with at least 20 workers. Annex B provides detail of the impacts of the reform for smaller employers.

Table 2.3: Impact on employers' contribution costs by number of employees

	Micro	Small	Medium	Large
Baseline	£420m	£1,120m	£650m	£1,310m
Earnings threshold	-£20m	-£10m	*	*

Source: Department for Work and Pensions Modelling
Note:
- Contribution costs are rounded to the nearest £10m, * indicates absolute values below £5 million
- Values are steady-state costs in 2011/12 earnings terms
- A micro employer is one with fewer than 5 employees, small with between 5 and 49 employees, medium with between 50 and 249 employees, and large with 250 employees or more.

Impact on the pensions industry

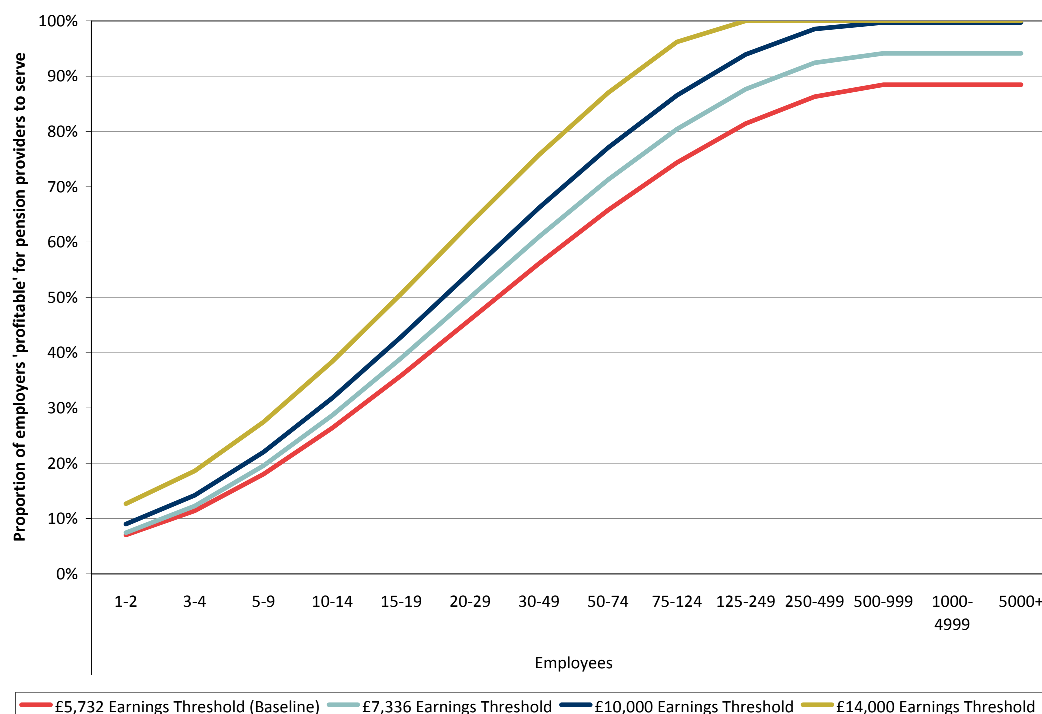
2.22 Separating the earnings threshold and the band on which contributions are paid will help reduce the number of small pots of pension savings which are disproportionately costly for the pensions industry to administer. In 2010/11 earnings terms, the smallest contribution going into a pension pot would be £130 per year with a threshold of £7336, £343 at £10,000

and £663 at £14,000. However the size of the pension pot accumulated will also depend on the persistency of the individual's saving.

2.23 The reduction in the number of savers in any given workplace pension scheme as a result of increasing the earnings threshold will reduce the total volume saved in that scheme and subsequently the total revenues generated from fund charges. However, on average, the impact of restricting the pool of eligible employees to those with higher salaries is sufficient to more than offset the impact of reducing the numbers sharing fixed costs: the average employer becomes 'more profitable' under higher earnings thresholds. This in turn increases the proportion of employers who can profitably be covered by the private pensions market.

2.24 This effect can be seen in Figure 2.1, which shows the proportion of employers that are 'profitable' to pension providers under a 0.5 per cent Annual Management Charge combined with a three per cent Contribution Charge for each of the options considered. Changing the earnings threshold to £7,336 in 2010/11 earnings terms (7,475 in 2011/12) increases the proportion of employers that are 'profitable' for all firm sizes, but has most impact on employers with 250 employees or more.

Figure 2.1 Profitability of pension provision under different earnings thresholds (2010/11 earnings terms)



Source: Department for Work and Pensions modelling

Impact on the Exchequer

2.25 The options to increase the earnings threshold have a minimal impact on savings for the Exchequer. This is because overall savings levels do not change significantly. Those who are enrolled still make contributions back to the lower earnings band (which hardly changes) and those who are no longer automatically enrolled would have been making small amounts of contributions in any case.

Waiting Periods

2.26 Under the existing arrangements in the Pensions Act 2008 employers are required to automatically enrol jobholders with effect from the automatic enrolment date. The only exception to this is where the employer offers a higher quality scheme (meeting certain requirements) and may therefore postpone automatic enrolment by three months.

Why consider change?

2.27 Many employers expressed concern that the existing policy could lead to costs associated with enrolling large numbers of employees working for short periods. A waiting period could alleviate this problem as well as easing the administrative burden by allowing employers more time to complete all the processes involved in automatic enrolment.

2.28 It may also increase the opportunity for the individuals to return the opt out form prior to deductions being taken from their salary, reducing the risk that refunds will have to be paid later.

Stakeholder views

2.29 Consumer groups were generally opposed to individuals having a waiting period before being automatically enrolled, as this could reduce the total amount of individuals saving, especially for those who have many jobs throughout their working life. They also argued that this change risked increasing the likelihood that individuals will opt out of pension saving.

2.30 Employer groups supported the introduction of waiting periods because they reduce the administrative cost and burden of enrolling people who are only with the employer for a short period of time and also allow probationary periods to pass before automatically enrolling individuals. They believe that waiting periods will: help employers to adjust to the additional cost of the duties; minimise the need for refunds; help reduce the risk of levelling down. It was also suggested that a waiting period could align with the Agency Workers Regulations 2010 and hence could ease agency burdens. Most stakeholders had a waiting period of at least 12 weeks in mind.

2.31 Many pension industry members and representatives supported waiting periods for similar reasons – partly to reduce the administrative costs associated with short-term workers and partly to reduce the need to administer small pots of pension saving.

Which options were considered?

2.32 The review team considered three options:

- Leave the policy as it is, with no waiting period;
- Introducing a waiting period of up to three months for all employees – suggested as an appropriate length by the majority of stakeholders who recommended a waiting period;
- Introducing a waiting period of up to six months for all employees.

Option chosen

2.33 A waiting period of up to three months was chosen to provide an easement to employers. The waiting period will replace the existing postponement option. In order to balance this easement against the risk to individuals' savings, jobholders will have the opportunity to opt in to a qualifying scheme at any point during the waiting period.

Impact on individuals

2.34 An optional waiting period of up to three months will reduce the number of individuals who are automatically enrolled on any particular day by up to 0.5 million individuals.[10] It will particularly affect young people, who are likely to move jobs relatively frequently.

Table 2.4: Impacts for individuals of different waiting periods

Waiting period	Individuals		
	Total coverage	% female	Other characteristics
0 months (baseline)	10-11m	38%	
3 months	-0.5m	37% (of 0.5m) No change to existing target group	Tend to be younger. No particular effect on people with disabilities. Slight adverse effect on ethnic minorities (see Annex E). No disadvantage overall, as individuals retain right to opt in during the waiting period.
6 months	-0.9m	39% (of 0.9 m) No change to existing target group	

Source: Labour Force Survey, April-June 2007, Office for National Statistics.

2.35 The impact of a waiting period of up to three months will depend on how many labour market interactions (the number of different employers an individual has) during their lifetime.

2.36 On average, our analysis suggests that individuals have 11 different labour market interactions during their lifetime. On that basis, a waiting period of up to three months could reduce an individual's accumulated saving by up to three years, which is equivalent to a seven per cent reduction in pension funds (if all employers operate the maximum waiting period).

2.37 For some individuals, such as those who remain on short-term contracts throughout their lives, the impact could be more significant. For individuals with full working histories, around two per cent have 20 or more labour market transactions (which is an average job length of two years).

2.38 Mindful of this potentially significant impact on individuals, the review team recommended that this be mitigated by allowing individuals to opt in to pension saving during the waiting period. This will enable all individuals, including those who move jobs more frequently, to benefit from the same levels of pension saving as defined in the existing rules should they wish to do so.

2.39 It is possible that waiting periods will increase opt-out rates. Individuals subject to a waiting period will receive a 'full' wage for some period, and will therefore be more acutely aware of the cost of contributing to a pension when they are eventually enrolled. While the behavioural economic theory of 'loss aversion' suggests this may discourage some individuals from remaining in a pension scheme, behavioural economics also predicts that 'inertia' will prevent the majority from opting out. What little evidence there is on this comes from the US, where schemes operating waiting periods of up to 12 months exhibit no adverse impact on participation.

[10] In our analysis, a three month waiting period is assumed to be used by all employers, therefore our figures show the maximum effect

Impact on employers

2.40 Employers will need to enrol fewer employees. It is estimated that of around two million enrolments per year in steady state, 190,000 enrolments are for employees who leave within three months.[11]

2.41 Allowing employers to operate a waiting period of up to three months will therefore reduce the regulatory and administrative costs associated with having to enrol then un-enrol significant numbers of short-term workers.

2.42 The waiting period will lessen the regulatory and administrative burden for all employers, but particularly those with high staff turnover. The most significant benefit will be for employers in the construction, distribution, hotel and restaurant industries who employ a greater proportion of short-term workers. For example, six per cent of employees in the construction, distribution and hotel industries were with their current employer for less than three months compared to four per cent of employees overall[12].
Employment agencies will also benefit from a waiting period, as 11 per cent of their worders are employed for less than two months and a further 21 per cent temp for between two and six months[13].

2.43 Table 2.1 shows that we can estimate the impact of a waiting period on the contribution and administrative costs that employers are likely to incur.

2.44 On contribution costs, we estimate that at any point in time, four per cent of the employed population have been employed for less than three months (with eight per cent of the employed population being employed for less than six months). This proportion is stable when measured across several time periods, meaning that even though individuals move in and out of work, the proportion of the employed population in work for less than three months remains at around four per cent. This forms the basis for the contribution costs modelling. As the waiting period will reduce the overall automatically enrolled population by four per cent, it follows that contributions will also fall by four per cent. Therefore, the contribution costs modelling works on the basis that the total number of individuals able to make contributions throughout the year is reduced, with a direct relationship between the fall in contributions and the fall in the number of individuals automatically enrolled.

2.45 On administrative costs, we estimate that, overall, employers will make ongoing annual savings of at least £3m with a three month waiting period (total administration costs are currently £132m) and an estimated £150m saving in contribution costs (total contribution costs are currently £3,510m)[14]. Table 2.5 sets out the impacts of this and the impacts of a waiting period of up to six months.

Table 2.5: impact on employers of waiting periods

Waiting period	Employer savings	
	Contribution costs	Administration costs
0 months (baseline)	£3,510m	£458m year one £132m ongoing
3 months	-£150m	-£7m in year 1 -£3m in ongoing years
6 months	-£290m	-£10m in year 1 -£6m in ongoing years

Source: Labour Force Survey 2007, Office for National Statistics.
Notes:

[11] Labour Force Survey 2007
[12] Labour Force Survey 2007
[13] REC: Key Recruitment Trends 2007
[14] Johnson P, Yeandle D, and Boulding A, 2010, Making automatic enrolment work – a review for the Department for Work and Pensions, Parliamentary Command Paper Cm 7954

- Values are steady-state costs in 2011/12 earnings terms
- Contribution costs are rounded to the nearest £10 million, administrative costs are rounded to the nearest £1 million.

2.46 Small and micro firms in particular will benefit from the waiting period because they have the highest levels of employee churn – 17 per cent of employees have less than one year's tenure compared to 14 per cent across all firms[15]. Annex B sets out the impacts for small employers in further detail.

Table 2.6 Impact on employers' contribution costs by firm size

	Micro	Small	Medium	Large
Baseline	£420m	£1,120m	£650m	£1,310m
Waiting period	-£20m	-£40m	-£20m	-£60m

Notes:
- Values are steady-state costs in 2011/12 earnings terms
- Contribution costs are rounded to the nearest £10m
- A micro employer is one with fewer than 5 employees, small with between 5 and 49 employees, medium with between 50 and 249 employees, and large with 250 employees or more.

2.47 Allowing employers the flexibility to select any automatic enrolment date within the three month waiting period also enables employers to align the automatic enrolment date with their existing payroll cycles. The overall administrative savings from this flexibility are relatively small since employers still have to meet the fixed costs associated with the duties, such as setting up a scheme.

Impacts on industry

2.48 The introduction of a waiting period effectively removes the highest 'churn' individuals (i.e. those who move jobs most frequently) from the ranks of new savers affected by automatic enrolment. That means that there are likely to be fewer small pension pots for the industry to administer, improved persistency of pension saving and also a reduction in the administrative costs associated with refunds where an individual opts out soon after being enrolled. That will reduce the costs providers incur, increasing profitability or leading to a reduction in charges for members. This reduction in charges could help to offset the overall reduction in pension saving that a waiting period may create for individuals, though we are not able to quantify this impact.

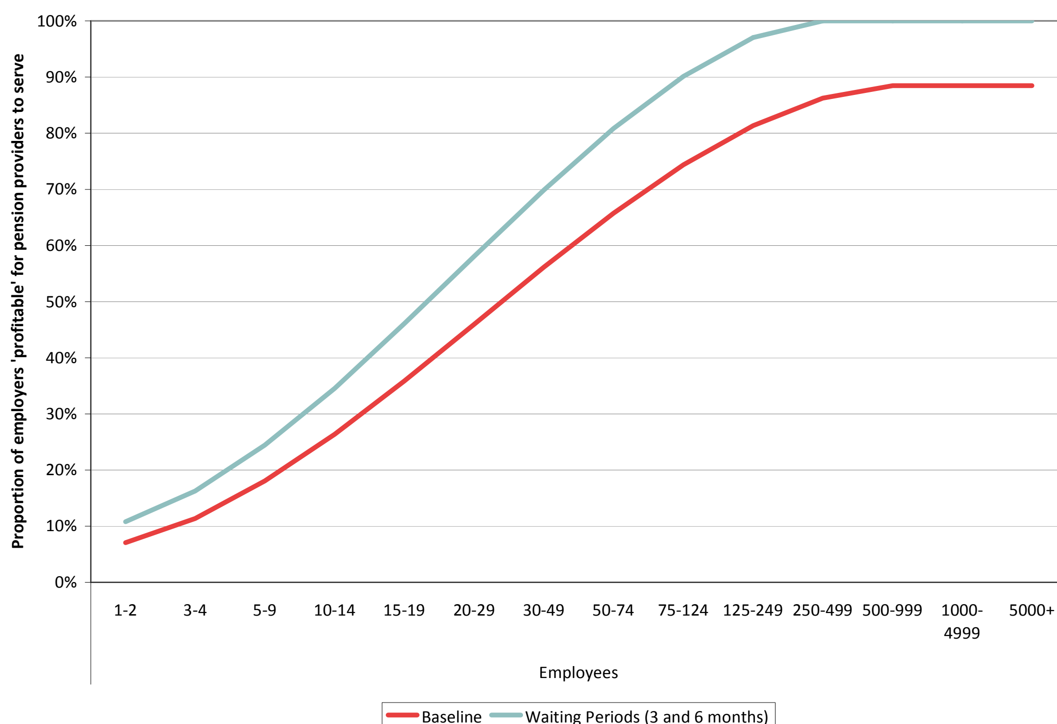
2.49 However, the waiting period also introduces a 'cost' to pension scheme providers, in that each stream of contributions becomes three or six months shorter. So an employee who remains with an employer for five years would end up making 57 monthly contributions with a three month waiting period (and 54 monthly contributions with a six month waiting period) to the pension scheme instead of 60.

2.50 Overall, the introduction of a waiting period has a significant effect on industry profitability, which is more pronounced for larger than smaller firms. The cost of extending the waiting period from three months to six months almost exactly outweighs the benefit of a longer waiting period; hence there is no difference in profitability between the two scenarios.

2.51 Our assessment of the impact on provider profitability is set out in Figure 2.2.

[15] ibid.

Figure 2.2: Profitability of pension provision under different waiting periods



Impact on the Exchequer

2.52 There will be Exchequer savings because at any point in time there will be slightly fewer individuals saving. That saving is estimated to be £100 million with a three month waiting period and £190m with a six month waiting period. As in the contribution costs modelling, we assume that exchequer costs on tax relief are directly related to the number of individuals automatically enrolled, with a change in the number of these individuals leading to a similar change in Exchequer costs.

Flexibility around re-enrolment

2.53 Under the terms of the Pensions Act 2008 and associated regulations, employers will be required to re-enrol eligible jobholders who had previously opted out or cancelled their membership. Employers must re-enrol such jobholders back into a workplace pension arrangement every three years, with a month's flexibility around the specific re-enrolment date. This provision reminds individuals to re-evaluate their circumstances and savings arrangements, and also prompts employers to ensure they continue to comply with the duties.

Why consider change?

2.54 To give employers greater freedom to undertake the re-enrolment process at a time that works for them.

Stakeholder views

2.55 Some employers have expressed concern that re-enrolment follows their initial staging date too precisely. That in turn creates a requirement for them to undertake activity at a time that may not be convenient for their business. They have suggested that employers should have more flexibility in choosing a re-enrolment date, provided it broadly comes three years after the staging date.

Which options were considered?

- Keep to the current system as prescribed: re-enrol eligible jobholders on the third anniversary of their staging date, and every three years thereafter, with a month's flexibility around the specific re-enrolment date.
- Allow employers a window of three months either side of the anniversary of their staging date, in which to complete re-enrolment.

Option chosen

2.56 The review recommended that employers be given greater flexibility around the date of re-enrolment, to allow them to align the timing with business needs. The intention is therefore that employers be allowed a window of three months either side of the anniversary or their staging date, in which to complete re-enrolment.

2.57 The details of this timing will be set out in secondary legislation. The only change to primary legislation via the Pensions Bill will be to the stipulation that employers may not complete re-enrolment more often than every three years. This will be amended to state that re-enrolment may be no more frequent than once in every two years and nine months.

Impact on individuals

2.58 The first time someone is automatically enrolled should not be the only time a jobholder is encouraged to save for a pension. This underlying rationale for re-enrolment remains unchanged: individuals who opt out or cancel their membership will be nudged to start or resume saving. A timely reminder through re-enrolment when their financial circumstances may have changed could make all the difference to the standard of living a jobholder is eventually able to afford in retirement. This re-enrolment nudge will still happen, broadly as originally envisaged, around every three years from the employer's staging date. It is unlikely that the change will have a significant impact on savings levels with three months gained (or lost) after a three-year hiatus.

Impact on employers

2.59 This is a matter of employer choice. If an employer wants to move the company's re-enrolment exercise to better suit their business, the employer is best placed to make that decision. Whilst there should be an administrative easement from this flexibility, it is likely that the overall impact on administrative costs will be minimal. The employer is still required to undertake a re-enrolment exercise broadly every three years. The obligation to carry out the exercise and the automatic-re-enrolment processes themselves remain the same.

Impact on the pensions industry

2.60 An employer's obligation to automatically re-enrol those workers who are not in a workplace pension remains, and the timetable is still, broadly, the same at every three years. It is therefore unlikely that the proposed change will have a significant impact on the pensions industry.

Impact on the Exchequer

2.61 As above, workers who are not in a workplace pension will continue to be re-enrolled, on average, every three years. The proposed change is thus unlikely to have a significant impact on overall exchequer costs.

A simple certification process

2.62 Under the Pensions Act 2008, employers will be required to pay contributions based on a band of qualifying earnings. It is the total earnings (including pay components such as overtime, bonuses, commission and shift allowances) that count in making this assessment.

Why consider change?

2.63 The definition of pensionable pay in the majority of existing money purchase schemes is not the same as qualifying earnings. Therefore it is difficult for employers to calculate whether their schemes meet the quality standard required for automatic enrolment.

2.64 A certification process allows an employer to 'certify' that overall their scheme satisfies the relevant quality criteria for money-purchase schemes. This avoids the need for a detailed calculation to demonstrate that contributions in respect of every individual in that scheme meet the minimum contribution requirement.

Stakeholder views

2.65 Employers have consistently said that, if they are required to make substantial changes to their systems, it may be simpler just to reduce their contribution rates to the statutory minimum.

2.66 Instead, they are keen to retain their existing schemes as these have been developed over time to reflect their business model and work force profile. Employers said they are keen to:

- do the right thing by their workers by complying with the legislation;
- continue to calculate their contributions on basic pay because large scale system changes are costly;
- have a simple process that does not require checking every single contribution record, as this can impose a huge administrative burden especially in the larger schemes; and
- have a process whereby, if changes in their pay structure mean that they become unable to re-certify, they are required to improve matters going forwards but are not required to make retrospective changes to pension contributions already made.

2.67 The pensions industry has consistently reinforced these arguments.

Which options were considered?

- Continuing with previous legislation by requiring employers to calculate their contributions using qualifying earnings or equivalent.
- Designing a simple model to allow employers with good money purchase schemes to certify that their pension arrangements meet the minimum requirements required by the Pensions Act 2008.

Option chosen

2.68 After collaborating closely with employers and other stakeholders, DWP has developed a simple certification process that balances the need for a straight forward process without diluting the core intent of the Act.

2.69 This proposal has been endorsed by the "Making Automatic Enrolment Work" review.

2.70 The certification process involves a simple three-stage test that allows employers to self-certify a scheme as qualifying if pensionable pay starts from the first pound of pay, and the scheme requires as a minimum for each member:

- a minimum nine per cent contribution of pensionable pay (including a minimum four per cent contribution from the employer);
- a minimum eight per cent contribution of pensionable pay (with a minimum three per cent contribution from the employer), providing that pensionable pay constitutes at least 85 per cent of total pay;

- a minimum seven per cent contribution of pensionable pay (with a minimum three per cent contribution from the employer) assuming that all pay is pensionable.

2.71 The detail of the simple certification process will be set out in secondary legislation. However, changes to the powers in primary legislation must be made via the Pensions Bill to deliver this easement for business.

Impact on individuals

2.72 Overall, individuals should benefit from this proposal because it will make it easier for employers to continue to provide current, often high quality, pension provision. There is a risk that some individuals could receive less than the minimum legislated for in the Pensions Act 2008. This risk is strongly mitigated by the minimum level of contributions required under the model. The model aims to strike the right balance between regulatory burden and protection for individuals. The potential for levelling down as a response to a more precise, but more onerous, certification model would introduce a more significant risk of detriment for individuals. The impact of the reforms on individuals will be monitored as part of the ongoing evaluation of the programme through implementation and beyond.

Impact on employers

2.73 This approach addresses the concerns of employers by allowing employers to continue to use basic pay to calculate pension contributions. The new model also recognises where an employer has an existing good quality scheme in place. Various certification models have been tested with employers and the version as set out above has their broad support. This easement will mean that these employers will not need to make expensive system changes, or unnecessarily overhaul their pension arrangements, to implement automatic enrolment.

Impact on the pensions industry

2.74 The simplified certification process is intended to minimise the burden associated with verifying that a workplace pension delivers at least equivalent benefits to those specified under automatic enrolment. The concern this addresses is that employers with "good" schemes would find it more economical to start a new scheme with potentially lower benefits than to go through complex validation processes with an existing scheme.

2.75 If employers replace an existing scheme with a new one, the pensions industry as a whole would essentially have borne the cost of setting up two schemes but would only accrue the benefits of revenues from one. We therefore expect the pensions industry to benefit from this proposal.

Impact on the Exchequer

2.76 The proposed change is unlikely to have a significant impact on overall Exchequer costs.

Impacts of legislative corrections

2.77 These are a series of minor changes to enhance existing legislation as set out in the Pensions Act 2008. The changes are intended to make minor corrections and amendments to the legislation as it is currently set out, and therefore there are no impacts to costs or benefits of the changes. The changes cover:

Transitional arrangements for defined benefit (DB) and hybrid schemes

2.78 Section 30 of the 2008 Pensions Act is intended to enable employers offering DB and hybrid schemes to delay automatic enrolment of relevant jobholders into such a scheme until the end of a transitional period, as long as certain conditions are met. This is intended to be a choice for the employer. However, as currently drafted in the Act the legislation makes it

compulsory for employers to use these transitional arrangements if they meet certain conditions. Legislation will therefore be included in the Pensions Bill to amend S30 to restore the policy intent of making the use of DB and hybrid transitional arrangements optional.

2.79 Defined benefit (DB) and hybrid scheme test
A minor amendment will be made for consistency to ensure that the test scheme can be expressed as a lump-sum accrual. This will allow the test scheme to apply to certain types of hybrid schemes, in particular Cash Balance and Final Salary Lump schemes.

Continuity of scheme membership

2.80 Minor amendments will be made to the arrangements for continuity of scheme membership under the 2008 Pensions Act, to prescribe an employer duty to re-enrol a jobholder into a replacement qualifying scheme if the individual either loses active membership of their original scheme or the original scheme ceases to be a qualifying scheme. As drafted the re-enrolment duty is missing from the 2008 Pensions Act.

Power of managers to modify by resolution

2.81 Section 32 of the Pensions Act 2008 provides that the trustees of an occupational pension scheme may by resolution modify the scheme so that it complies with the requirements for an automatic enrolment scheme. The measure extends section 32 of the Pensions Act 2009 so that managers, as well as trustees, of occupational pension schemes are able to use this power to modify a scheme.

No indemnification for penalties and fines

2.82 A minor amendment will be made to ensure that trustees or managers of pension schemes cannot take money out of scheme funds to pay for any 2008 Pensions Act penalties and fines issued to them by TPR. It also prohibits trustees or managers from being reimbursed from the scheme for payment and this includes indemnity insurance.

Service rules

2.83 A minor amendment will set out the rules governing the service of compliance notices and documents sent by the Pensions Regulator. These will provide clarity and certainty on whether or not, when and how such notices and documents will be treated as having been delivered.

Annex A: Baseline figures for changes

A1. The following tables show the baseline costs and benefits of the reform under the current legislation, that is, earn more than £5,035 a year (in 2006/07 terms) and no waiting period. In later tables, the impacts of the waiting period and the change to the earnings threshold are separated out, so that the effects of each element of the reform can be identified. In all tables, costs are expressed in 2011/12 price terms.

A2. Presented here are average annual changes over 39 years, followed by the one off cost and then the change in 2012 (which, due to phasing and staging of the automatic enrolment policy, is small). Finally, changes every ten years are shown, with an increased effect in later years due to population and earnings growth. ***Aggregate private pension incomes*** in 2050 are currently estimated to increase by around £12 to 17 billion a year (in 2011/12 prices), or £6 to 8 billion a year in 2011/12 earnings terms.[16]

Tables in this section present net benefits: an additional cost is a negative number, an additional benefit is a positive number.

Reform baseline – income transfers

A3. Table A1.1 shows the impact of the changes as set out in the Pensions Bill on income transfers between different agents at specific points in time through to 2050.

Table A1.1: Estimated transfer costs and benefits arising from workplace pension reform measures (£ million)

	Annual average	One-off cost (present value)	2012	2020	2030	2040	2050
Individuals							
a) Contribution costs	-5,940	0	-20	-5,070	-6,180	-7,530	-9,180
b) Receipt of income related benefits	-340	0	0	-10	-250	-550	-960
c) Savings into private pension	12,200	0	50	10,380	12,650	15,430	18,810
Net benefit	**5,920**	**0**	**30**	**5,300**	**6,230**	**7,350**	**8,660**

[16] These figures have been revised since the last Impact Assessment.

Table A1.1 contd: Estimated transfer costs and benefits arising from workplace pension reform measures (£ million)							
Employers							
d) Contribution costs	-4,570	0	-20	-3,870	-4,720	-5,750	-7,010
Net benefit	**-4,570**	**0**	**-20**	**-3,870**	**-4,720**	**-5,750**	**-7,010**
Government							
e) Contribution costs (tax relief)	-1,690	0	-10	-1,440	-1,760	-2,140	-2,610
f) Income related benefit expenditure	340	0	0	10	250	550	960
Net benefit	**-1,350**	**0**	**-10**	**-1,430**	**-1,510**	**-1,590**	**-1,650**
Total							
Net Benefit	**0**	**0**	**0**	**0**	**0**	**0**	**0**

Notes:

- The annual average reduction in income-related benefit (IRB) expenditure is small because most of the reduction in IRB expenditure takes place at the end of the period up to 2050. When looking at the final ten years (2040 to 2050) the annual average reduction in IRB expenditure increases to £800 million per year (11/12 prices). The benefits of the reform will continue to accrue beyond this time as those automatically enrolled and newly saving throughout this period gradually reach retirement. This assumes that the benefit system will not change in any way. The housing benefit cap has not been included in this analysis and therefore the figures may be slightly over estimated; however the cap will affect only a minority of pensioners and therefore will not have a significant impact on the results.
- Costs and benefits are in 2011/12 price terms; present values are 2011/12-based.
- Figures are rounded to the nearest £10m.

Reform baseline – resource costs/benefits

A4. The resource costs of auto-enrolment under the baseline are displayed in Table A1.2.

Table A1.2: Estimated resource costs arising from workplace pension reform measures (£ million)							
	Annual average	One-off cost (present value)	2012	2020	2030	2040	2050
g) Employer administrative costs	-170	-170	-10	-150	-170	-210	-250
h) Cost of changing scheme rules	0	-70	0	0	0	0	0
Net Benefit	**-170**	**-250**	**-10**	**-150**	**-170**	**-210**	**-250**

Notes

- Costs and benefits are in 2011/12 price terms; present values are 2011/12-based.
- Figures are rounded to the nearest £10m.

A5. Table A1.3 compares the contribution costs of the baseline, and each element of the review recommendation. Changes to the earnings threshold are separated out from the impact of introducing the waiting period, but the combined impact is also presented. Figures presented here represent an average over 39 years following the reform. Changes are presented both in terms of absolute cost, and a percentage change. Although the earnings threshold has a greater impact on volumes (see Table 1.6), its impact is concentrated at the lower end of the income distribution, so the effect on contributions is minor. However, the waiting period is expected to have an effect distributed fairly evenly across incomes, so the impact on contributions is greater. ***Aggregate private pension incomes*** in 2050 are currently estimated to be reduced from around £12 to £17 billion, to £10 to 16 billion (11/12 prices), or from £6 to 8 billion to £5 to 8 billion (11/12 earnings).

Table A1.3: Estimated transfer costs and benefits arising from workplace pension reform measures, 39-year averages in 2011/12 price terms (£ million)

	Baseline	Earnings threshold			Waiting period			Both		
Individuals										
a) Contribution costs	-5,940	-5,880	60	-1%	-5,690	250	-4%	-5,660	280	-5%
b) Receipt of income related benefits	-340							-310	20	-6%
c) Savings into private pension	12,200	12,080	-120	-1%	11,680	-520	-4%	11,610	-590	-5%
Net benefit	**5,920**							**5,640**	**-280**	**-5%**
Employers										
d) Contribution costs	-4,570	-4,530	40	-1%	-4,370	190	-4%	-4,350	220	-5%
Net benefit	**-4,570**	**-4,530**	**40**	**-1%**	**-4,370**	**190**	**-4%**	**-4,350**	**220**	**-5%**
Government										
e) Contribution costs (tax relief)	-1,690	-1,670	20	-1%	-1,610	80	-5%	-1,600	90	-5%
f) Income related benefit expenditure	340							310	-20	-6%
Net benefit	**-1,350**							**-1,290**	**60**	**-5%**
Total										
Net Benefit	**0**							**0**	**0**	**0%**

Note: Figures are rounded to the nearest £10m.

A6. The effects of the new earnings threshold and waiting period on resource costs when compared to the baseline are displayed in Table A1.4. The figures here represent a 39 year average, converted to 2011/12 price terms.

Table A1.4: Estimated resource costs arising from workplace pension reform measures, averages in 2011/12 price terms (£ million)

	Baseline	Earnings threshold			Waiting period			Both		
g) Employer administrative costs	-170	-170	10	-3%	-170	*	-2%	-170	10	-4%
h) Cost of changing scheme rules	0	0	0	0	0	0	0	0	0	0
Net Benefit	**-170**	**-170**	**10**	**-3%**	**-170**	**0**	**-2%**	**-170**	**10**	**-4%**

Note: Figures are rounded to the nearest £10m.

A7. In addition to the direct financial impacts of the introduction of auto-enrolment, we have also assessed the impacts to resource and social welfare of the amendments. These are displayed in Table A1.5.

Table A1.5: Estimated resource benefits arising from workplace pension reform measures (£ billion)

	Baseline	Earnings threshold and Waiting Period		
Individuals				
Social Welfare Benefits	40 – 60	40 – 60	+1 to -2	+2 to -4%

Note: Figures are rounded to the nearest £10 billion.

- 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 2012-2050, and are presented in 2011/12 prices.

A8. Impacts on the overall volumes eligible for automatic enrolment are shown in Table 1.6. Moving the earnings threshold to £7,475 has a slightly greater impact than introducing the waiting period, but both amendments combined will reduce volumes eligible for automatic enrolment by approximately 1m.

Table A1.6: Estimated impact on participation volumes

	Baseline	Earnings threshold	Waiting period	Both
Individuals				

a) Eligible for Automatic Enrolment	10m – 11m	9m – 10m	-0.6m (-6%)	9m – 10m	-0.5m (-4%)	9m – 10m	-1m (-10%)

Note: Figures are rounded to the nearest million.

Annex B – Impact on small firms

What is a small firm?

B1. 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.

Background

B2. Overall the majority of UK employers are small or micro, but employ a minority of the workforce: while micro employers represent 66 per cent of all employers, they employ only 12 per cent of the workforce. The majority (72 per cent) of workers are employed by firms with at least 20 employees. This means that strategies targeted at reducing burdens for micro employers would potentially have a more limited impact on workers.

B3. The duties set out in the 2008 Pensions Act will apply to all companies or individuals who employ one or more workers in Great Britain. Our previous Impact Assessment[17] set out the full impacts of the reform legislation for small employers in detail.

B4. Complying with the reforms will entail new roles and processes for all employers, for example in carrying out automatic enrolment into a workplace pension and in registering with the Pensions Regulator. In addition, for many employers, and particularly small and micro employers, the process of providing a workplace pension in itself will be new. Employers with existing pension provision will have to go through new processes to ensure that their schemes comply with the requirements for scheme quality, and to take decisions regarding their contribution levels.

B5. Under these circumstances the review looked very carefully at the question of whether there was a case for excluding micro-employers from the scope of the policy (see Annex H). The review decided against this, but instead focussed on a suite of easements for employers, some of which would have larger benefits for smaller employers. This is because the characteristics of small and micro firms are very different to that of other employers, as explored in more detail below.

Characteristics of smaller employers

B6. A range of key characteristics of employers, broken down by employer size, is shown in Table B.1 below.

[17] *Workplace Pension Reform Regulations – Impact Assessment*, Department for Work and Pensions, January 2010 – Annex A

Table B.1: Summary of key employer characteristics

	Employer size *number of employees*					
	1	**2 – 4**	**5 – 9**	**10 – 19**	**20 +**	**All**
Employers *row percentages*	16	50	18	9	6	100
Proportion of total UK workforce *row percentages*	2	10	8	8	72	100
Earnings of workers employed by firms within each size category *column percentage*						
<£5,000	13	13	11	9	8	8
£5,000 - £9,999	28	25	17	13	11	12
£10,000 - £14,999	21	19	18	17	13	14
£15,000 - £19,999	15	15	17	17	15	16
£20,000+	24	29	37	44	53	51
Proportion of workforce who are women *percentage*	44	48	46	44	50	50
Annual workforce churn *percentage*	17 (1–19)				12	14
Proportion of employers offering any pension provision *percentage*[1]	8	5	24	33	52	15
Proportion of employers offering pension provision with a contribution *percentage*[1]	8	3	20	24	44	12
Average proportion of employer's workforce that are members overall (those with provision only) *percentage*[1]	-	76	46	44	31	32
Average proportion of employer's workforce that are members of a pension scheme AND receive employer contributions (those with provision only) *percentage*[1]	-	53	41	36	29	30

[1] Only including employers with at least one active member

Source: Small and Medium Enterprise Statistics, United Kingdom 2008, Department for Business, Innovation and Skills
Annual Survey of Hours and Earnings, Great Britain 2009, Office for National Statistics
Employers' Pension Provision Survey, Great Britain 2009, Department for Work and Pensions

B7. This table shows that:

- Women are slightly more likely to work for smaller employers than larger employers.
- Smaller employers have a higher proportion of lower earners than their larger counterparts.
- Annual workforce churn is higher amongst smaller employers.
- Larger employers are much more likely to provide access to pension schemes, and to provide a contribution.

Research evidence on small employers

B8. 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. [18] 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.

Existing easements for employers

B9. There are a number of significant easements for employers within the current legislation:

- Whilst larger employers start to automatically enrol their workers from October 2012, micro employers aren't required to automatically enrol their workers until at least August 2014 (though there is a small test group who will automatically enrol their workers in March 2014).
- The minimum contribution employers need to make increases gradually. So employers will be required to contribute one per cent until September 2016. They will then be required to contribute two per cent until September 2017. From October 2017 they will be required to contribute the full three per cent. That gives employers the time to adjust to the costs involved.

New easements

B10. There are also a number of new easements, recommended as part of the Making Automatic Enrolment Work review, and covered by this Impact assessment:

- Waiting periods. As we have already seen, smaller firms have higher staff turnover than larger firms, and so will benefit more than larger firms from a waiting period.
- Earnings thresholds. Since smaller employers tend to have a higher proportion of relatively low wage workers, they will benefit more from a higher earnings threshold than their larger counterparts.
- Flagging. Part of the rationale for the decision not to exclude small and micro firms was the conviction that NEST will provide a pension scheme that will be appropriate for most small employers and one which will be very easy for them to use. The review recommended that, in communicating with these employers, The Pensions Regulator should flag up in the clearest and strongest terms possible, that NEST has been designed to meet their needs. In addition there needs to be a well structured and concerted communications exercise to ensure that as many small employers as possible know and understand what is expected of them.
- Other easements. The review noted that, ideally, some way should also be found to assure smaller employers that they will not be held liable for their scheme choice should something subsequently go wrong. The Department for Work and Pensions will look into ways it can provide maximum possible comfort to employers in these circumstances, particularly if they opt for NEST or a stakeholder scheme to fulfil their new duties.

[18] Philpin, C, and Thomas, A, 2007, Understanding *small employers' likely responses to the workplace pension reforms: report of a qualitative study,* DWP Research Report No. 617.

Annex C: Competition impacts

C1. A full competition assessment of the impact of reforms on the pensions industry is set out in the previous impact assessment to the pension reforms[19]. The introduction of automatic enrolment will create demand for workplace pensions where there was previously little, for example among smaller employers, but departmental analysis predicts a shortfall in supply in these same parts of the market. NEST has been designed to fill that gap, with minimal impact on other parts of the market. As such, practices like flagging that could otherwise be expected to place other pension providers at a competitive disadvantage to NEST should have minimal competition impacts. Nevertheless it is important to keep this under review: NEST is being introduced into a part of the pensions market where it faces no competition, but it is entirely possible that competitors may wish to enter the market in the future, at which point policies like flagging will need to be reviewed.

C2. Similarly, in stimulating demand for workplace pensions across the market, automatic enrolment affects all pension providers equally and so should increase the size of the market overall rather than distorting equilibria within it. Changes discussed in this Impact Assessment such as the introduction of waiting periods and increases to earnings thresholds will slightly reduce that demand. They will also remove some of the least profitable individuals from the reforms, slightly increasing profitability. Competition impacts of these changes, though, are negligible.

[19] *Workplace Pension Reform Regulations – Impact Assessment*, Department for Work and Pensions, January 2010

Annex D: Gender impact assessment

D1. As described in detail in the Workplace Pension Reform Regulations Impact Assessment[20], women's pension provision is generally poorer than men's. This is due to a number of reasons, including women receiving lower salaries compared with men, and lower levels of economic activity in women.

D2. 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.

D3. Under the new legislative changes set out in the Pensions Bill, Government estimates show that nine to ten million people will be eligible for automatic enrolment into a qualifying workplace pension scheme, of which three to four million are expected to be women.[21]

D4. It is expected that an increase to the earnings threshold will make women less likely to be part of the group that will be automatically enrolled. This is because women overall tend to earn less than men. Under the Pensions Act 2008, women comprised 40 per cent of the eligible group. As a result of raising the earnings threshold alone, women would comprise 38 per cent of those earning above the new earnings threshold of £7,475 (the 2011/12 PAYE threshold).[22] However, persistent low earners tend to find that the State, through pensions and benefits, provides them with a sufficiently high replacement rate without the need for additional saving. For these individuals, it may not be beneficial to redirect income during working life into pension saving. Furthermore, everyone who is not automatically enrolled because of the increase in the earnings threshold will retain the right to opt in, with an employer contribution, and employers will be required to provide information about this.

D5. It is anticipated that the introduction of a universal waiting period of up to three months will not particularly affect women. If all employers choose to operate a three month waiting period it is estimated that around two in five individuals affected will be women. Taking this recommendation alone, overall, 38 per cent of the eligible group are expected to be women, the same proportion as without any waiting period.[23]

D6. Taken as a whole, the new legislative changes set out in this Impact Assessment will mean that the proportion of women in the group eligible for automatic enrolment into a qualifying pension scheme will decrease from 38 per cent to 37 per cent.[24]

[20] Workplace Pension Reform Regulations – Impact Assessment, Department for Work and Pensions, January 2010, Annex C
[21] Department for Work and Pensions modelling.
[22] Annual Survey of Hours and Earnings, Great Britain 2009, Office for National Statistics
[23] Labour Force Survey, April – June 2007, Office for National Statistics
[24] ibid.

Annex E: Race impact assessment

E1. 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 the Workplace Pension Reform Regulations Impact Assessment. Under the Pensions Act 2008, employees in these groups were affected proportionately more than all employees, as these groups are over-represented in the target group for automatic enrolment.

E2. Figure E.1 shows that employees from all ethnic groups are relatively equally represented in the group of moderate to low earners eligible for automatic enrolment. Under the introduction of an increased earnings threshold of £7,475 (the 2011/12 PAYE threshold), the composition of the eligible group remains at 12 per cent black and minority ethnic groups (BME).

Figure E.1 Distribution of eligible employees without a qualifying pension by earnings and ethnic group

						Row percentage
	Individual gross earnings					
	£5,824-£7,474	£7,475-£9,999	£10,000-£13,999	£14,000-£19,999	£20,000-£24,999	£25,000 and over
White	6	9	15	26	16	27
Mixed	5	9	14	26	18	28
Indian	6	6	17	24	17	30
Pakistani and Bangladeshi	9	12	25	25	11	18
Black or Black British	6	7	14	26	17	32
Other Ethnic Groups	6	8	18	21	14	33
All	6	9	16	26	16	28

Source: UK Family Resources Survey, 2003/04, 2004/05, and 2005/06
Note. Analysis based on employees aged 22 to State Pension age, all pension provision is assumed to be qualifying

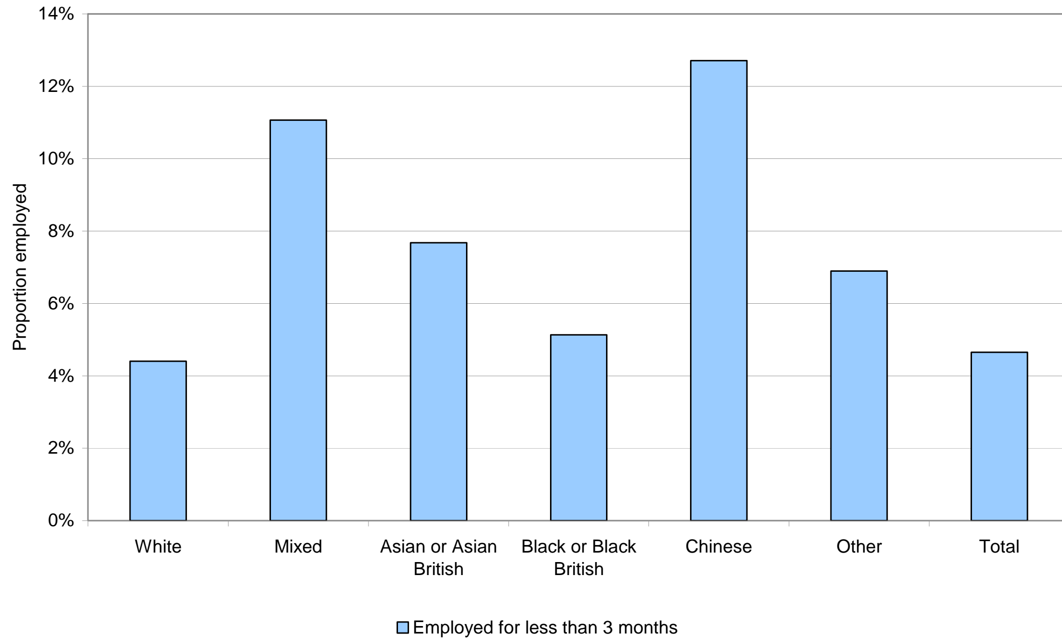
E3. Figure E.2 shows that all minority ethnic groups are more likely to be in their current employment for less than three months, than white individuals.

E4. While employees in work for less than three months will not now be automatically enrolled into pension saving, they will be permitted to opt in with an employer contribution and their employer will be required to provide information about this.

E5. The waiting period will mean that some jobholders who would have opted out of pension saving anyway will not be automatically enrolled, short term workers may be more likely to opt out. It also allows potential for a probationary period to pass before an employer enrols an individual. Furthermore, allowing a waiting period reduces the risk of levelling down by employers.

E6. Taken as a whole, the new legislative changes set out in this Impact Assessment are not expected to have a particular effect on BME groups.

Figure E.2 Proportion of eligible group in work for less than three months, by ethnicity



Source: Labour Force Survey, 2007

Annex F: Disability impact assessment

F.1 People with disabilities are a diverse group, comprising people with a wide range of impairments with differing severity[25]. Although the different definitions of disability used in research makes consistent analysis difficult, it is generally the case that disabled people are significantly less likely to be in employment than those who are not disabled; 48 per cent of disabled people are in employment compared to 77 per cent of non disabled people.[26]

F.2 Disabled people tend to have been in work for more time than non-disabled people. Only seven per cent of those employed and classified as disabled under the Disability Discrimination Act (2005) have been in work for less than six months, compared with nine per cent of the non-disabled population. Therefore a waiting period would be unlikely to particularly affect disabled people.

F.3 Table F.1 shows that employees who are disabled are equally represented in the group of moderate to low earners eligible for automatic enrolment. Therefore, increasing the earnings threshold to £7,475 (the 2011/12 PAYE threshold) does not particularly affect disabled employees.

Figure F.1 Distribution of eligible employees without a qualifying pension by earnings and disability

	Row percentage					
	Individual gross earnings					
Disability status	£5,824-£7,474	£7,475-£9,999	£10,000-£13,999	£14,000-£19,999	£20,000-£24,999	£25,000 and over
Disabled	8	12	19	26	14	22
Not disabled	5	8	15	27	16	28
All	6	9	16	27	16	27

Source: UK Family Resources Survey 2005/06
Note. Analysis based on employees aged 22 to State Pension age, all pension provision is assumed to be qualifying

F.4 Taken as a whole, the new legislative changes set out in this Impact Assessment are not expected to have a particular effect on disabled people.

[25] Berthoud, R, *The employment rates of disabled people*, DWP Research Report No 298.
[26] *Labour Force Survey, Quarter 2, 2009*

Annex G: People saving due to private pension reform - explanation of participation estimates

Background

G1. The Pensions Act 2008 encourages and enables more people to save towards their retirement. This Annex presents analysis on the impact of the amendments to this legislation encompassed in the Pensions Bill on the number of people saving in a workplace pension scheme.

G2. Under the new legislative changes set out in the Pensions Bill and analysed in this Impact Assessment, from 2012, workers between the age of 22 and State Pension Age, with annual earnings in at least one job of more than £7,475 (the 2011/12 PAYE threshold) will be eligible for automatic enrolment into a qualifying pension scheme, unless they are already participating in such a scheme. In addition, employers may also operate a waiting period of up to three months before automatically enrolling employees into a qualifying scheme, with jobholders having the option to opt in to a qualifying scheme at any point during that period. It will be for the employer to choose the qualifying scheme into which they enrol their jobholders. The new NEST scheme will be one option open to employers and aims to complement existing workplace pension provision.

G3. 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 January 2010[27]. An Annex was previously published alongside the Impact Assessment for the Pensions Act 2008 explaining how our participation estimates had changed since the 2007 Impact Assessment[28].

G4. There is inherent uncertainty around these figures; it is uncertain how the pension and economic landscape may change in the years leading up to the reforms. Although the assumptions set out here are informed by a programme of research, employers and individuals may change their behaviour in response to the reforms. This is why the analysis presented here includes low, principal and high scenarios for all our trend and behavioural assumptions, and why figures are 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. The analysis also assumes that all employers will operate the maximum three month waiting period for all employees[29].

G5. DWP 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 their understanding of how the reforms will affect employers, individuals and the financial services industry.

Headline Figures

G6. Under the new legislative changes set out in the Pensions Bill, around nine to ten million people are expected to be eligible for automatic enrolment into a workplace pension scheme. After accounting for people who opt out it is anticipated this will result in:

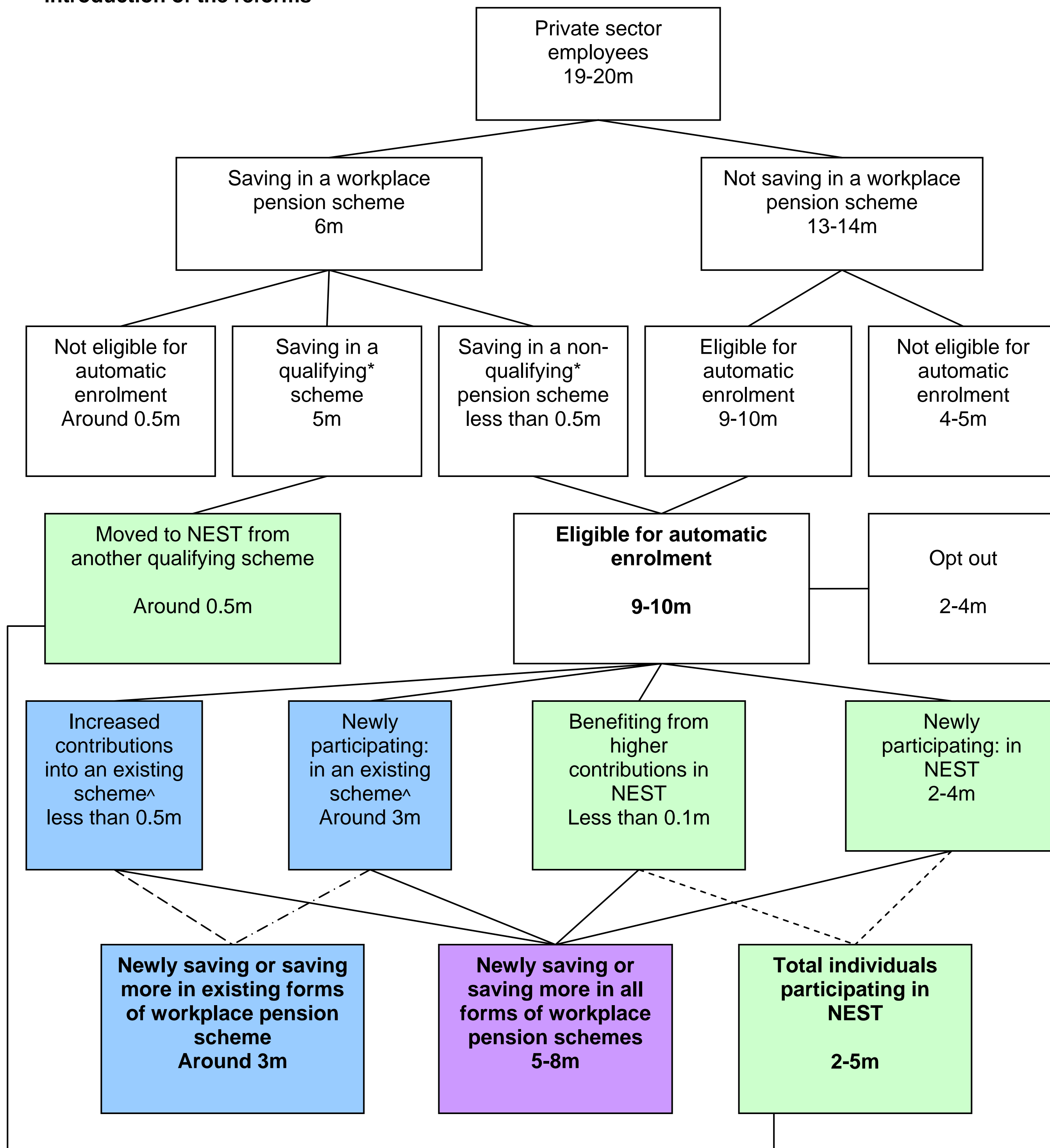
- 5 to 8 million people newly saving or saving more in all forms of workplace pension scheme, of these 2 to 3 million will be women;
- around 3 million people newly saving or saving more in existing forms of workplace pension scheme; and

[27] Available here: http://www.dwp.gov.uk/docs/wpr-ia.pdf
[28] Available here: http://www.dwp.gov.uk/docs/pensionsbillimpactassessment-final2.pdf
[29] In practice employers will have flexibility of up to three months.

- 2 to 5 million people saving in the NEST scheme, of these 1 to 2 million will be women. This includes some who were previously saving in existing forms of workplace pension scheme, and some who opt in.

G7. Figure G.1 sets out the range the estimates take for the number of people eligible for automatic enrolment, and the increase in number of people who are expected to be participating in the NEST scheme or in other forms of workplace pension scheme after the reforms are introduced.

Figure G.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. It is assumed that all defined benefit schemes qualify in this analysis.
^ This is an existing or newly set up workplace pension scheme, other than the NEST scheme.

Assumptions underpinning participation estimates

G8. Our post-reform participation estimates are modelled in four key steps. Firstly, modelling the current pension landscape in terms of employer provision of pension schemes and participation by employees. Second, this landscape is projected forward to when the reforms will be implemented. Third, using evidence from research with employers assumptions are made about whether employers will use the new NEST scheme, their existing schemes, or other provision to fulfil their duty to provide a qualifying pension scheme to their workers. Fourth, using evidence from research with eligible individuals assumptions are made about how many people will opt out of a scheme upon being automatically enrolled by their employer. This section gives further information about each of these steps.

Current pension landscape

G9. The estimate of the current pension landscape is derived from the Employers' Pension Provision (EPP) survey[30], weighted to the Inter-Departmental Business Register (IDBR) statistics. This has changed since the last time participation estimates were published, so that the EPP data are now weighted to the IDBR rather than the Small and Medium Enterprise statistics as were previously used. Based on analysis of the 2007 EPP survey, it is estimated that in 2012, 13 per cent of employers will offer a pension scheme with an employer contribution of three per cent of pay. This means that around 87 per cent will not offer a qualifying[31] pension scheme.

G10. New data from the 2009 Annual Survey of Hours and Earnings (ASHE) has also been incorporated, to identify the group of people who would be eligible for automatic enrolment based on the new eligibility criteria, as defined by the amendments to the Pensions Act 2008. This identifies those aged between 22 and State Pension age, who earn over the new earnings threshold of at least £7,475 (the 2011/12 PAYE threshold).

G11. It is impossible to predict which employers will operate a waiting period. Therefore, for the purposes of participation estimates it is assumed that all employers do so for the maximum period of three months. We estimate the size of the cohort of high churn workers who will be removed from the auto enrolment process using the 2007 Labour Force Survey. We identify employees who have been in their current employment for less than three months and reduce the eligible group by this proportion. As a result, it is estimated that 14 to 15 million employees will meet the eligibility criteria, and that around 5 million of these will be members of a qualifying pension scheme.

Projecting forward the 2007 landscape

G12. To understand the number of employers and employees that the pension reforms will affect when they are introduced, the 2007 pension landscape is projected forward to 2012. These estimates now take account of the impact on employment of the recent recession.

Employment and employer projections

G13. The analysis takes account of expected changes in the number of employers and the number of individuals in employment. Economic indicators have been used to develop assumptions about the number of employers in 2012, by firm size. It is anticipated that there will be around 1.3 million employers in 2012.

G14. Our projections of the overall population employed in the private sector are projected forward using Labour Market Statistics and the average of independent forecasts published by HM Treasury. The principal assumption is that employment will fall until 2012. We therefore estimate that there will be 19 to 20 million private sector employees in

[30] Forth, J and Stokes, L, 2008, *Employers' Pension Provision Survey 2007*, DWP Research Report 545.
[31] Taking an employer contribution of at least 3 per cent into a current workplace pension scheme as a proxy for a scheme that is likely to qualify under the Pensions Act 2008.

2012. It is further estimated that 14 to 15 million of these will be within the eligible group as defined by the amendments to the Pensions Act 2008.

Pension projections

G15. To project forward our 2007 estimates of the pension landscape it is assumed that trends in pension provision observed between 2003 and 2007 continue and that these trends are reflected in membership, with employers turning away from trust-based occupational schemes in favour of less expensive workplace personal pension schemes. This analysis estimates that around five million employees will be saving in a qualifying scheme when the reforms are implemented in 2012.

G16. Using these projections, the assumption here is that between nine and ten million workers will be eligible for automatic enrolment when the reforms are introduced. This compares with the previous estimate that between ten and eleven million workers would be eligible for automatic enrolment; the reduction in the eligible group being due to the effect of increasing the earnings threshold, and the introduction of a three month waiting period. These totals include around half a million people who are expected to be receiving an employer contribution of less than three per cent.

Employers' choice of pension scheme

G17. Some firms who do not currently offer a qualifying pension scheme may be deemed unprofitable by pension providers, and will therefore have no choice over the pension scheme. Based on DWP modelling, two to three million employees are expected to be enrolled into NEST because their employer is deemed unprofitable by any other pension provider.

G18. For those employers who can choose what sort of scheme they use to fulfil their new duties, the current assumption uses results from NEST's 2009 Employer Decision Making Survey (EDMS), and takes account of the impact that intermediary advice will have on employers' decisions. It is estimated that around one million employers will use the NEST scheme for at least some of their employees. Analysis indicates that two to three million employees will be enrolled into NEST (by employers who are not deemed unprofitable), and nine to ten million employees will be enrolled into other qualifying schemes.

Opt-out by individuals

G19. Although all eligible employees will be automatically enrolled into a qualifying pension scheme, participation is not compulsory and employees will have the opportunity to opt out. To estimate the number of individuals who will opt out the analysis uses evidence from the DWP's 2009 Individuals Attitudes Survey (IAS). Using the responses to this survey, and taking account of the age and earnings distribution of those in the group eligible for automatic enrolment, it is estimated that one to two million employees will opt out of NEST, and one to two million employees will opt out of other qualifying schemes. This leaves two to five million employees participating in NEST, and around eight million employees participating in other qualifying schemes.

Annex H: Options that were considered by the review but not recommended

Excluding micro employers

H1. The review team explored the option of excluding different sizes of employers (focusing mostly on micro employers with fewer than five employees) from the scope of the automatic enrolment reforms, considering the cost savings to employers against the lost benefits to employees.

H2. The rationale for excluding micro employers is primarily around the burdens faced by these firms in complying with the employer duties, since they have the least experience and confidence in setting up and running pension schemes. Further, the smallest employers employ a relatively small fraction of the workforce and thus their administrative costs generate proportionately less pension incomes.

H3. The review team was also particularly concerned about single-person employers, such as those individuals hiring nannies and carers, who may be poorly placed to comply with the reforms.

H4. On balance the review team decided against excluding any size of employer on the following grounds:

- Excluding micro employers would result in 1.5 million people being excluded from pension saving for no reason relating to the value to them of saving

- There would be significant equality impact, with 71 per cent of those excluded being men

- Including all employers ensures a level competitive playing field and guards against any disincentives for business growth that might arise from excluding particular sizes of employer

- Operationally it would be very difficult to implement a size cut-off, particularly in relation to circumstances where employers shrink in size from above the cut-off to below

Changes to the age thresholds for automatic enrolment

H5. The review considered whether to reduce the ***upper age limit*** for eligibility for automatic enrolment. Their chief concern was that older workers could end up saving for short periods for relatively little benefit, particularly during implementation whilst contributions are phased in.

H6. However, many older workers will still benefit from saving, including those with existing savings which will be topped up by automatic enrolment contributions. Even for those without prior pension savings, many will be able to trivially commute their pension pots at retirement and benefit from saving that way. Thus the review decided against changes to the upper age threshold for automatic enrolment. This was supported by employer and employee representative groups, who opposed any reduction in the upper age limit.

H7. The review also briefly considered whether to reduce the ***lower age limit*** for eligibility for automatic enrolment, in line with some stakeholder calls for alignment with the age limits for National Minimum Wage. The review concluded that the lower threshold is a balance between establishing patterns of saving earlier and avoiding automatically enrolling very young people with high labour market churn (e.g. those working in temporary jobs whilst in tertiary education), and that the current threshold of 22 strikes the right balance between these aims.

Flexibility around staging

H8. Responding to strongly-held views from employer representatives, the review team considered a number of ways to increase flexibility for employers around their staging dates, or to minimise competition impacts, including: total flexibility during implementation; allowing employers to select any day within a specified month; and staging agencies in together.

H9. The primary arguments against these approaches are operational, based on the capacity of TPR and NEST to process a certain volume of employers in any particular month. Total flexibility is likely to lead in practise to a 'big bang' approach or common commencement dates, with 1.3 million employers choosing to come under the duties on a handful of dates. Similarly, staging agencies together would involve 1.3 million individuals being automatically enrolled within a single month.

H10. The review concluded that the risks to successful implementation were too high to recommend either of these approaches. They felt that the option to allow a month's staging window would be unnecessary in light of the flexibility provided by the proposed waiting period, to allow employers to select any date for automatic enrolment within a three month window.

Opt-out before auto enrolment

H11. Under the arrangements within the 2008 Pensions Act, individuals have a month in which to opt out of pension saving. Industry and employer representatives responding to the review consultation expressed concerns about the administrative burden imposed by processing opt-outs and refunds. The review team therefore considered allowing employees to opt out of pension saving prior to automatic enrolment – and thus avoid being automatically enrolled.

H12. This option would represent an administrative easement for employers, who would avoid some of the burden in enrolling and then un-enrolling eligible jobholders and processing refunds. Pension providers would also avoid some administration, since they would not have any dealings with individuals who opted out prior to auto enrolment.

H13. However, the review team decided against recommending this option because:

- Automatic enrolment is the cornerstone of the private pension reforms and to unpick this risks undermining the desired behavioural outcomes of automatic enrolment.

- It would require significant amendments to the 2008 Pensions Act, which would jeopardise the planned timing for implementation.

Calculating contributions from £1

H14. Under the 2008 Pensions Act, qualifying earnings are defined as a band of gross earnings between £5,035 and £33,540 (in 2006/07 terms) and include a number of variable pay items such as overtime, bonuses, commission and shift allowances. However, this will be an unfamiliar and potentially burdensome calculation for most employers, who typically base pension contributions on basic pay, calculated from the first pound of earnings.

H15. Based on concerns expressed by employer and industry representatives, the review therefore considered amending the Act to move away from the current definition of qualifying earnings and allow contributions to be calculated on basic pay and from the first pound of earnings. This would potentially reduce burdens on employers with existing pension arrangements, who would not have to change the way in which they calculate contributions.

H16. However, if contribution levels were kept at eight per cent, this would represent an increase in contributions (depending on the ratios of pensionable pay to total pay) that would be unaffordable for all parties:

- Individual contributions would increase by around £1.2 to £5.5 billion per annum. Where contributions increase, these are likely to be felt most keenly by lower earners, and the proposal would create a cliff-edge in contributions for those earning just above the eligibility threshold.

- Employer contributions would increase by around £940 million to £4.2 billion per annum, including an increase of £440 million per annum in costs to small and micro employers.

- Tax relief costs would increase by around £370 million to £1.6 billion per annum, with overall exchequer costs increasing by £610 million to £2 billion per annum.

H17. For this reason the review team decided not to recommend this option. They further felt that the simple certification would do much to provide an administrative easement to employers with existing pension arrangements.

Removing the NEST contribution cap

H18. The 2008 Pensions Act sets out that an order made under the Act must prescribe a maximum amount of contributions paid with respect to a member of NEST; presently this amount is set at an annual limit of £3,600 (in 2005/06 earnings terms).

H19. Following some calls from employer and consumer representatives, the review considered whether to increase or remove this cap. This would have the benefit of increasing flexibility and simplicity for employers and individuals, and would help to avoid a possibly misleading (if unintended) message that saving £3,600 per year is enough.

H20. However, the pensions industry remain concerned that removing the contribution cap would risk shifting the focus of NEST away from its target market of low to median earners who would otherwise struggle to find low cost pension provision.

H21. The review team have therefore recommended that the cap remain in place throughout implementation of the reforms, whilst NEST “beds in”, but that it should be removed in 2017.

Annex J: Amendments made during the Pensions Act's passage through Parliament

J1. The following measures were included as amendments during the Pensions Act's passage through Parliament. The Bill became an Act of Parliament on 3 November 2011, and this Impact Assessment has been updated to reflect these changes. These measures have no new regulatory impacts on business and civil society organisations.

Qualifying schemes – administration charges

J2. With reference to section 10.

J3. Section 10 extends the existing reserve power in the Pensions Act 2008 to establish a charge cap for qualifying schemes used to fulfil an employer's duties under Part 1 of the Pensions Act 2008, so that it would apply to charges made to deferred members as well as to charges made to active members. It would also clarify what charges are subject to the cap.

J4. As the Act provides the Secretary of State with a power to set a cap through regulations, the change will have no significant impact on business, or civil society organisations; nor create any costs to the public sector.

J5. The measure will have no significant impact on individuals, nor will it create any equal treatment issues.

Test scheme standard for schemes that produce sum of money for provision of benefits

J6. With reference to section 11.

J7. The "test scheme standard" is the quality requirement for defined benefit schemes with members in employments that are not contracted out of the State Second Pension Scheme. The test scheme standard uses a benchmark known as the "test scheme".

J8. Section 11 enables provision to be made in regulations for the detail of the test scheme. It also clarifies the test scheme standard by re-classifying cash balance schemes as defined benefit schemes.

J9. The change will have no significant impact on business, individuals or civil society organisations; nor create any costs to the public sector

Certification for non-UK schemes

J10. With reference to section 13. See pages 29-30 of this Impact Assessment for further details of the impact of the certification measure on schemes.

Arrangements where transitional conditions cease to be satisfied

J11. With reference to section 15.

J12. If an employer is using the transitional arrangements for defined benefit and hybrid schemes and certain conditions cease to be satisfied, the employer must automatically enrol the jobholder into an alternative scheme. Section 15 extends flexibility for employers by allowing them to use a personal pension scheme as an alternative in these circumstances as well as a defined benefit, hybrid or money purchase scheme.

J13. See page 31 of this Impact Assessment for further details of the transitional arrangements for defined benefit and hybrid schemes.

Power to exempt certain cross-border employment from enrolment duty

J14. With reference to section 18.

J15. There is a potential overlap between the Cross Border Regulations, which deal with the provision of services by a pension scheme based in the UK with respect to an employee who is subject to the social and labour laws of another European Economic Area (EEA) State, and the automatic enrolment duty. This overlap could compromise the employer's ability to comply with the duty. This is because it can be complex and costly for schemes to accommodate pension rights acquired by individuals working in another EEA State, and there is no obligation for schemes to do so.

J16. Section 18 provides the Secretary of State with a power to make regulations that would exclude individuals that fall under the Cross Border Regulations from automatic enrolment.

J17. As the Act provides the Secretary of State with a power, the change will have no significant impact on business, or civil society organisations; nor create any costs to the public sector.

J18. The measure will have no significant impact on individuals, nor will it create any equal treatment issues