Title: **Workplace Pension Reforms** **IA No:** DWP00001b **Lead department or agency:** Department for Work and Pensions **Other departments or agencies: n/a**	**Impact Assessment (IA)** **Date:** 24/05/2012 **Stage: Final** **Source of intervention:** Domestic **Type of measure:** Primary legislation Contact for enquiries**:** Jo Semmence: 020 7449 7226
Summary: Intervention and Options	RPC Opinion: Green

Cost of Preferred (or more likely) Option				
Total Net Present Value	**Business Net Present Value**	**Net cost to business per year** (EANCB on 2009 prices)	**In scope of One-In, One-Out?**	**Measure qualifies as**
£-4,200m	£-64,000m	£-2,820m	YES	IN

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 and 2011 Pensions Act, is to reverse the culture of under saving and enable low to moderate earners to save more for their retirement. The Pensions Act 2008 introduced a series of measures centring on 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.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

The Pensions Act 2008 gives the Secretary of State regulation-making powers to ensure that the reforms are implemented effectively and fairly with minimal employer burden. Policy options were considered in impact assessments published with draft regulations for consultation in 2009. The 2011 Pensions Act (Part 2) stems from an independent review that was carried out during summer 2010. The review provided a critical analysis of the rationale underpinning the approach, identifying whether alternative approaches could improve outcomes (for individuals, employers, industry) and value for money. It incorporated a series of workshops and discussions with employers and their representatives, industry representatives and consumer groups as well as a call for evidence. An assessment of all the options and impacts is contained in "Making Automatic Enrolment Work" (http://www.dwp.gov.uk/docs/cp-oct10-full-document.pdf). This IA brings together the IAs for the 2010 Regulations and Pensions Act 2011 (Part 2) to reflect the net position.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** 2017

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	Micro Yes	< 20 Yes	Small Yes	Medium Yes	Large Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** N/A	**Non-traded:** N/A	

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) that the benefits justify the costs.

Signed by the responsible Minister: Steve Wells **Date:** 3/07/12

Summary: Analysis and Evidence

Description:

FULL ECONOMIC ASSESSMENT

Price Base Year 2011	PV Base Year 2011	Time Period Years 39	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	**High:** Optional	**Best Estimate: 140**

COSTS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional	0	Optional	Optional
High	Optional		Optional	Optional
Best Estimate	250		15,700	282,000

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 (2011/12) prices (including increases in earnings over and above the rate of inflation).
They represent transfers into individuals' pensions from employers (see Table 4), individuals and Government of £15.1 billion and a reduction in income related benefits of £0.3 billion.
Resource costs: employer administrative costs of £0.2 billion (see Table 5).

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

BENEFITS (£m)	Total Transition (Constant Price)	Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional	0	Optional	Optional
High	Optional		Optional	Optional
Best Estimate	0		15,500	277,000

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 (2011/12) prices (including increases in earnings over and above the rate of inflation).
They represent transfers into individuals' pensions from employers, individuals and government of £15.1 billion and a reduction in income related benefits of £0.3 billion.

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

Benefits to individuals of consumption smoothing (equivalent to around £35 to £60 billion up to 2050). This amount does not represent a financial transfer but represents the perceived value to individuals from transferring income from more affluent times to retirement.

Key assumptions/sensitivities/risks — **Discount rate** 3.5

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

Direct impact on business (Equivalent Annual) £m):			In scope of	Measure qualifies
Costs: 2,940	Benefits: 0	Net: -2,940	YES	IN

Summary

1. The figures presented in the summary above show the costs and benefits of the workplace pension reforms as set out in the Pensions Act 2008 and associated regulations and the Pensions Act 2011. They have been updated to reflect the latest economic assumptions for long term inflation and earnings growth (see paragraph 18), latest evidence about the employer and pensions landscape and the application of a labour market adjustment. All figures are shown in 2011/12 prices unless stated otherwise. The impact of these reforms has already been examined in detail by the Department in a number of previous publications (see below). These publications also provide analysis of the wider impacts and description of the implementation plan.

2. This evidence base focuses on describing the methodology used in applying a labour market adjustment to the estimate of the Equivalent Annual Net Cost to Business (EANCB) associated with the overarching workplace pension reforms as set out in the Pensions Act 2008 and the Pensions Act 2011. It also contains analysis of the employer costs of the reforms before and after the application of a labour market adjustment.

3. The evidence presented focuses on the impact on employers. Employee and government impacts were taken into account in the initial impact assessments supporting the Pensions Act 2008 and Pensions Act 2011.

References

- Pensions Bill Impact Assessment – April 2008

- Impact Assessment:(Automatic Enrolment) Regulations – March 2009 (consultation stage)

- Impact Assessment: Workplace Pension Reform (Completing the Picture) Regulations – September 2009 (consultation stage)

- Workplace Pension Reform Regulations: Impact Assessment – January 2010

- Making Automatic Enrolment Work Review – October 2010

- Pensions Act 2011: Workplace Pension Reform Impact Assessment – December 2011

Key new evidence available since the publication of the Pensions Act 2011 impact assessment

4. The analysis in this impact assessment is based on the latest evidence about the employer and pensions landscape, which suggests that there are around 1 million fewer workers currently saving in a qualifying workplace pension scheme and around 150,000 fewer micro employers (those with less than five workers) than was assumed in Pensions Act 2011 impact assessment. The reduction in the number of workers currently saving has the effect of increasing the baseline costs and benefits of the overarching workplace pension reforms.

The reduction in the number of micro employers reduces their share of the costs and benefits associated with the reforms compared with larger firms.

Background

5. The impact assessment for the move from the Retail Prices Index (RPI) to using the Consumer Prices Index (CPI) as the basis for the statutory minimum up-rating of occupational pensions was published on 12thJuly 2011[1]. Reflecting the opinion of the Regulatory Policy Committee (RPC), this impact assessment assumed a complete labour market adjustment over a period of 3 years, and calculated the Equivalent Annual Net Cost to Business (EANCB) over a period of 39 years. On this basis, the RPC validated the resultant EANCB figure of £3,342 million, expressed in 2011/12 price terms.

6. An assessment of the impact of the labour market reaction to the workplace pension reforms was not included in the impact assessment accompanying the Pensions Act 2011. This was due to a lack of substantive information – at the time the impact assessment was produced - on how the labour market might adjust as well as the speed and completeness of potential adjustment to the costs incurred by the introduction of the automatic enrolment duty. Following RPC validation of the labour market adjustment applied in the RPI/CPI impact assessment, the Department reviewed the impact assessment of the workplace pension reforms to ensure the regulatory impact is assessed on a consistent basis, including a labour market adjustment and calculating the EANCB over a period of 39 years.

7. Whilst the RPI/CPI impact assessment assumed a full labour market adjustment within three years, the Department considers that the labour market adjustment will be more limited in the case of the workplace pension reforms. This is discussed following a summary of the latest estimates of the costs to employers - before labour market adjustment – of the main reforms as set out in Pensions Act 2008 and Pensions act 2011.

Employer costs of workplace pension reforms – before labour market adjustment

8. This section summarises the impact on employers' pension contributions and administration costs of the workplace pension reforms as set out in the 2008 Pensions Act and the Pensions Act 2011. Costs are presented before application of a labour market adjustment.

9. The following tables show the average annual cost over 39 years, followed by the one-off cost and then the cost in 2012 (which, due to phasing and staging of automatic enrolment policy, is small). Finally, costs every ten years are shown; the increased effect in later years is due to earnings growth.

10. Table 1 shows estimates of the impact of minimum employer contributions due to the workplace pension reforms for specific points in time through to 2050.

Table 1: Estimated cost of annual employer minimum contributions at specific points in time (£ million)

[1] Impact of the move to CPI for occupational Pensions 2011. Department for Work and Pensions. http://www.dwp.gov.uk/docs/cpi-private-pensions-consultation-ia-120711.pdf

	Annual average	One-off cost (present value)	2012	2020	2030	2040	2050
Employer contribution costs	-5,700	0	-100	-4,700	-5,800	-7,200	-9,000

Notes:

- Figures are expressed in 2011/12 price terms; present values are 2011/12 based.
- Costs shown include increases in earnings over and above price inflation.
- Figures are rounded to the nearest £100 million.
- The employer costs presented here are the sum of employer contributions and any tax relief available on those contributions.
- Costs are presented as negative numbers, benefits as positive numbers.

11. Table 2 shows the estimated resource cost arising from the workplace pension reforms for specific points in time through to 2050. The one-off cost includes the components of the year one costs that arise only in the first year of implementation for all firms. The other figures are the costs of the processes that will need to be completed on an ongoing basis. The cost of changing the scheme rules relates to the cost of reviewing the rules and making required changes to all open occupational schemes in the run up to the reform.

Table 2: Estimated resource costs arising from the workplace pension reform measures at specific points in time (£ million)

	Annual average	One off cost (present value)	2012	2020	2030	2040	2050
Employer administrative costs	-210	-180	-20	-170	-210	-260	-320
Cost of changing scheme rules	0	-70	0	0	0	0	0
Net Cost	**-210**	**-250**	**-20**	**-170**	**-210**	**-260**	**-320**

Notes:

- Figures are expressed in 2011/12 price terms; present values are 2011/12 based.
- Costs are presented as negative numbers, benefits as positive numbers.
- All figures are rounded to the nearest £10 million.

12. Table 3 shows the Net Present Value cost to business over the 39 years from 2012 to 2050 of the contribution and administrative components of the reforms alongside the Equivalent Annual Net Cost to Business on 2011/12 prices.

Table 3: Net Present Value and Equivalent Annual Net Cost to business of the workplace pension reforms

	Net Present Value (£ billion)	Equivalent Annual Net Cost (£ million)
Employer minimum contribution cost	-103	-4,710
Employer resource cost	-4	-190
Total Net Cost	**-107**	**-4,900**

Notes:

- Figures are expressed in 2011/12 price terms; present values are 2011/12 based.
- Costs are presented as negative numbers, benefits as positive numbers.

- Net Present Values are rounded to the nearest one billion. The Equivalent Annual Net Cost to Business (calculated from the unrounded NPV) is rounded to the nearest one million.

Labour market assumption for workplace pension reforms

13. The Department considers that the labour market will adjust to offset 50 per cent of the costs arising from additional pension contributions for workers automatically enrolled, and that this will occur over a period of ten years. This is for the following reasons:

    - The regulatory burden has been highlighted as a concern by employers and their representatives. It is considered that a 10 year horizon is consistent with employers' views of their ability to react to the reforms and will be considered realistic by representatives of business. Adopting a quicker labour market reaction would likely be regarded as underestimating the regulatory impact of the reforms.

    - The labour market is not completely flexible for many of those impacted by the reforms. Around one in ten of the group eligible for automatic enrolment (around one million people) earn within 50 pence of the National Minimum Wage[2]. This represents a sizeable number of workers for whom the labour market will be unable to offset the additional costs of mandatory pension contributions.

    - A partial adjustment also reflects the mandatory nature of the reforms. Employers are required to provide a minimum contribution to a workplace pension to individuals who, in the main, have not previously chosen a pension. The individuals have additional employment rights which restrict how the employer can manage the cost of these pension contributions (for instance the employer cannot explicitly offer an individual higher pay in exchange for opting out of the pension). Further, there is an element of asymmetrical information between employers and individuals: individuals typically find pensions more difficult to value than employers, and given these are individuals (and often employers) who would not have chosen to voluntarily contract to provide pension arrangements this could reduce the ability to compensate for higher pension contributions through lower wages.

    - Further, evidence from employers themselves on their initial response suggests that not all the additional costs of pension contributions are likely to be passed onto individuals. For example, around one third of employers said they would seek to absorb the added costs out of profits or higher overheads. Whereas, 18 per cent of employers said they would respond to the increased cost of total pension contributions by offering lower wage rises and a further 16 per cent said they would restructure the workforce[3].

14. The combination of factors above point towards a partial labour market reaction. The Department has therefore adopted a labour market adjustment over a time period of ten years, and a partial labour market adjustment of 50 per cent.

15. The Department also considered whether it would be appropriate to apply this labour market adjustment to employer administration costs. The majority of the first year administrative costs for all firms cover preparations for start-up, for example: investigating existing

[2] http://statistics.dwp.gov.uk/asd/asd1/adhoc_analysis/2011/wpr_eligible_target_groups.pdf
[3] Bewley H and Forth J, 2010, 'Employers' attitudes and likely reactions to the workplace pension reforms 2009: Report of a quantitative survey', Department for Work and Pensions Research Report No 683

schemes; deciding how best to provide a qualifying scheme; adapting or purchasing in-house or internal payment systems; training staff; and communicating with workers. While the Department accepts the argument that some of these costs may be offset by adjustments to the labour market, as a large proportion are fixed costs, the labour market adjustment has not been applied to the administrative costs. As such, the labour market adjustment has been applied only to the costs incurred by employers in respect of mandatory pension contributions for workers automatically enrolled.

Approach to analysis

16. The Department has assessed the impact of a labour market adjustment of 50 per cent over ten years on the total cost to business in making minimum pension contributions. This adjustment to the cost of the reforms has been applied linearly on an employer-level basis, considering the phasing of contributions[4] and the staging of employers by size[5]:

- When an employer's duty falls[6], it is assumed they face the full contribution costs for the first month in respect of all employees automatically enrolled.

- From the second month on, it has been assumed that they are able to begin to offset the costs of these pension contributions at a rate of around 0.42 per cent each month for 120 months (i.e. 50 per cent over ten years).

- When an employer's contributions increase in line with the phasing profile, it has been assumed that whilst the previous costs continue to adjust, the additional costs are initially experienced in full (for the first month), and are subsequently offset at the same rate of around 0.42 per cent each month for 120 months (i.e. 50 per cent over ten years).

- As a result of this approach, the cost to employers in respect of pension contributions reaches a steady state in October 2027 (10 years after the final contribution increase from phasing).

17. The Department has estimated the total cost of the reforms over a 39 year time period in order to be consistent with the opinion of the RPC in relation to the RPI/CPI impact assessment, and also the methodology used in previous impact assessments relating to the workplace pension reforms. As such, the residual 50 per cent of costs after the application of the ten year labour market adjustment continue to increase in line with projected average earnings until 2050.

18. Long term inflation is assumed to be 2.5 per cent and long term earnings growth is assumed to be 4.75 per cent in nominal terms. The previous version of this impact assessment assumed long term inflation at 3.2 per cent. This change was made to improve consistency with other impact assessments on pensions. 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.

[4] The required employer contributions are 1 per cent of qualifying earnings from 2012, then 2 per cent from October 2016, reaching 3 per cent from October 2017.

[5] The labour market adjustment during staging may be complex. Sensitivity testing was undertaken assuming that the labour market started its adjustment in October 2016, when the staging of employers is complete. This increased the total cost to business from minimum pension contributions from 2012 to 2050 by £1 billion.

[6] The staging period runs from October 2012 to September 2016. The largest employers are staged first through to the smallest.

Employer Costs of Workplace Pension Reforms – after labour market adjustment

19. The following tables show the average annual cost over 39 years, followed by the one-off cost and then the cost in 2012 (which, due to phasing and staging of automatic enrolment policy, is small). Finally, costs every ten years are shown; the increased effect in later years is due to earnings growth.

20. Table 4 shows estimates of the impact of minimum employer contributions due to the workplace pension reforms for specific points in time through to 2050.

Table 4: Estimated cost of annual employer minimum contributions applying a labour market adjustment of 50 per cent over 10 years at specific points in time (£ million)

	Annual average	One-off cost (present value)	2012	2020	2030	2040	2050
Employer contribution costs	-3,100	0	-100	-3,700	-2,900	-3,600	-4,500

Notes:

- Figures are expressed in 2011/12 price terms; present values are 2011/12 based.
- Costs shown include increases in earnings over and above price inflation.
- Figures are rounded to the nearest £100 million.
- The employer costs presented here are the sum of employer contributions and any tax relief available on those contributions.
- Costs are presented as negative numbers, benefits as positive numbers.

21. Table 5 shows the estimated resource cost arising from the workplace pension reforms for specific points in time through to 2050. The one-off cost includes the components of the year one costs that arise only in the first year of implementation for all firms. The other figures are the costs of the processes that will need to be completed on an ongoing basis. The cost of changing the scheme rules relates to the cost of reviewing the rules and making required changes to all open occupational schemes in the run up to the reform. Note, as explained in paragraph 15, a labour market adjustment is not applied to resource costs.

Table 5: Estimated resource costs arising from the workplace pension reform measures at specific points in time (£ million)

	Annual average	One off cost (present value)	2012	2020	2030	2040	2050
Employer administrative costs	-210	-180	-20	-170	-210	-260	-320
Cost of changing scheme rules	0	-70	0	0	0	0	0
Net Cost	**-210**	**-250**	**-20**	**-170**	**-210**	**-260**	**-320**

Notes:

- Figures are expressed in 2011/12 price terms; present values are 2011/12 based.
- Costs are presented as negative numbers, benefits as positive numbers.
- All figures are rounded to the nearest £10 million.

22. Table 6 shows the Net Present Value cost to business over the 39 years from 2012 to 2050 of the contribution and administrative components of the reforms alongside the Equivalent Annual Net Cost to Business on 2011/12 prices.

Table 6: Net Present Value and Equivalent Annual Net Cost to business of the workplace pension reforms		
	Net Present Value (£ billion)	Equivalent Annual Net Cost (£ million)
Employer minimum contribution cost	-60	-2,750
Employer resource cost	-4	-190
Total Net Cost	**-64**	**-2,940**

Notes:

- Figures are expressed in 2011/12 price terms; present values are 2011/12 based.
- Costs are presented as negative numbers, benefits as positive numbers.
- A labour market adjustment of 50 per cent over 10 years is applied to the employer minimum contribution cost.
- Net Present Values are rounded to the nearest one billion. The Equivalent Annual Net Cost to Business (calculated from the unrounded NPV) is rounded to the nearest one million.

Regulatory Policy Committee	OPINION	
Impact Assessment (IA)	Workplace Pension Reforms (Automatic Enrolment) (Impact on business)	
Lead Department/Agency	Department for Work and Pensions	
Stage	Final	
Origin	Domestic	
Date submitted to RPC	30/05/2012	
RPC Opinion date and reference	28/06/2012	RPC12-DWP-1398
Overall Assessment	GREEN	

The IA is fit for purpose. Based on the evidence presented the assessment of the net direct cost to business appears reasonable.

Identification of costs and benefits, and the impacts on small firms, public and third sector organisations, individuals and community groups and reflection of these in the choice of options

We note that the policy decision surrounding the Workplace Pension Reforms (Auto-enrolment) has already been made and that the purpose of the current IA is purely to assess the direct cost to business of this proposal for 'One-in, One-out' purposes for reporting in the next Statement of New Regulation.

Based on the evidence presented the assessment of the direct cost to business appears robust. We note that the key assumptions used in estimating the impacts on business in this IA, such as the assumptions about the labour market adjustment and consequential treatment of the impacts on employers as direct impacts for One-in, One-out purposes, are consistent with the previous pensions IAs already validated by us (e.g. RPI/CPI IA).

Have the necessary burden reductions required by One-in, One-out been identified and are they robust?

The IA says that the proposal is a regulatory measure that will impose a net cost to business (an 'IN') with an Equivalent Annual Net Cost to Business (EANCB) of £2,820m. This is consistent with the current One-in, One-out Methodology (paragraph 17) and provides a reasonable assessment of the likely impacts.

Signed **Michael Gibbons,** Chairman