DWP Department for Work and Pensions

Workplace Pension Reforms: Baseline Evaluation Report

A report of research carried out by the Department for Work and Pensions

Summary

Millions of individuals in the UK are not saving enough for their retirement. The Workplace Pension Reforms are a response to some of the key challenges facing the UK pensions system. Once fully implemented, the reforms aim to transform the culture of saving and increase the number of individuals newly saving or saving more in a workplace pension by around eight million, within a range of six to nine million, and increase the amount that is being saved in workplace pensions by around £11 billion a year within a range of £8 billion to £12 billion a year.[1]

This baseline report is the first following the Workplace Pension Reforms Evaluation Strategy[2] and aims to describe the landscape before implementation of the reforms. The report is structured around the eight key Evaluation Questions outlined in the Strategy. Subsequent reports monitoring the effects of the reforms will be published on an annual basis during implementation.

Delivery of the reforms

The policy and legislative framework for the reforms is in place. The new duties on employers to automatically enrol eligible workers into a qualifying pension scheme and make a minimum contribution will be staged in between October 2012 and February 2018, with the largest employers being staged in first. Employer and employee contributions will be phased in, rising to a minimum total contribution of eight per cent of a band of earnings by October 2018, with a minimum contribution of three per cent from employers, in addition to a Government contribution in the form of tax relief.

National Employment Savings Trust (NEST), a new low-cost pension scheme aimed particularly at low to moderate earners and small employers, launched in 2011 with a small number of employers on a voluntary basis to enable a period of live operation before the onset of the employer duties. NEST has a Public Service Obligation to accept all employers that want to use the scheme to fulfil either all or part of their employer duties.

The Pensions Regulator (the regulator) has an Employer Compliance Regime in place to ensure employers comply with their new duties. The regime is based on encouraging a proactive compliance culture amongst employers so that they are aware of and understand their obligations, want to comply with their legal duties and believe that non-compliance by other employers is unacceptable. The regulator will adopt a policy of education, enablement and enforcement in relation to automatic enrolment, will use a proportionate approach to tackling non-compliance and where appropriate use sanctions.

[1] Figures shown are in 2012/13 earnings terms. Full details on the costs and benefits to individuals, employers, industry and Government are set out in the Department's published Impact Assessment, 2012, at: http://dwp.gov.uk/docs/wpr-rev-implementation-ia.pdf

[2] *Workplace Pension Reforms Evaluation Strategy*. DWP Research Report No. 764, 2011. At: http://statistics.dwp.gov.uk/asd/asd5/report_abstracts/rr_abstracts/rra_764.asp

Employer awareness[3]

All employers will receive two letters from the regulator: one at 12 months and another at three months ahead of their staging dates[4]. The current levels of awareness and understanding amongst employers show appropriate progression towards employers being able to prepare for automatic enrolment and comply with their duties. The regulator's research shows employer awareness among larger employers is high (88 per cent of large employers and 80 per cent of medium) compared to smaller employers (47 per cent of small and 25 per cent of micro employers), reflecting their later staging dates. Communications activity so far has been focused on large employers who are brought into the reforms first (from October 2012).

Employer awareness of the specific duties to automatically enrol employees and make contributions is high, at 94 per cent and 93 per cent respectively for large employers, 87 per and 84 per cent for medium employers and 64 per cent and 67 per cent for small employers. Awareness of these duties was lowest for micro employers at 38 per cent and 46 per cent.

Overall support for automatic enrolment also varied with employer size, ranging from nearly three quarters of large employers (74 per cent) agreeing it was a good idea to less than half (44 per cent) of micro employers.

Increasing the number of savers

One of the key policy objectives of the reforms is to increase the number of individuals saving in workplace pensions. Automatic enrolment aims to harness individuals' inertia in thinking about retirement and pension saving, while preserving individual responsibility for the decision to save by allowing them to opt out. Evidence suggests that the requirement for employers to make minimum contributions will be an effective incentive to encourage individuals to remain saving in a pension and not opt out after being automatically enrolled[5].

Current trends in workplace pension participation show a small but steady decline in saving amongst those eligible for automatic enrolment, from a high of 12.6 million (64 per cent) in 2003 down to 11.0 million (56 per cent) in 2011. While public sector pension participation has remained high (5.2 million, 88 per cent in 2011), private sector pension participation has fallen from 7.9 million (55 per cent) in 1997 to 5.8 million (42 per cent) in 2011. Low earners, individuals working for small and micro employers (under 50 employees) and the youngest age groups (aged 22 to 29) have experienced steep declines in participation rates[6].

Female pension participation amongst those eligible for automatic enrolment remains high in the public sector (88 per cent in 2011) but has fallen in the private sector from a high of 55 per cent in 2003 to 39 per cent in 2011 and has been consistently five or six percentage points lower than for male[7]. Pension participation amongst eligible disabled and ethnic group employees has remained relatively stable. Participation of disabled eligible employees has remained fairly constant at 62 per cent in 2009/10 which is slightly higher than the rate for non-disabled individuals (58 per cent). The White ethnic group continues to have the highest pension participation rate, 61 per cent between 2007/08 and 2009/10. While the gap has narrowed slightly, the lowest pension participation is still the Pakistani and Bangladeshi ethnic group at 35 per cent in the same period[8].

Opt out will be a key indicator of the effectiveness of automatic enrolment to get more individuals saving in a workplace pension. Research with individuals prior to implementation provides an indication of potential levels of opt out. While there is obviously a degree of uncertainty at this early stage, it is expected that around two-thirds (65 per cent) of

[3] The Pensions Regulator, Tracker Survey, Autumn 2011, at: http://www.thepensionsregulator.gov.uk/docs/ecr-employer-tracker-research-2011.pdf Large (250+ employees), medium (50 to 249 employees), small (five to 49 employees) and micro (one to four employees).

[4] The large employers also received an initial letter 18 months ahead of their staging date.

[5] Bryan, M. *et al.*, (2011) *Who Saves for Retirement?*. Institute for Economic and Social Research (ISER) & Strategic Society Centre. At: http://haec-clients-public.s3.amazonaws.com/ssc/pdf/2011/12/07/Who_Saves_for_Retirement.pdf

[6] DWP estimates derived from the Office for National Statistics (ONS) Annual Survey of Hours and Earnings (ASHE, GB).

[7] Ibid.

[8] Analysis derived from the DWP Family Resources Survey (FRS, UK). Owing to the volatility of single year results, due to small sample sizes, ethnic group analysis is presented as a three-year average.

individuals will remain in pension saving. Of those individuals who said they were undecided or would probably or definitely opt out, only one-tenth (nine per cent) said they would definitely opt out. More than half (54 per cent) of those who said they would probably or definitely opt out, gave affordability as the reason to opt out[9].

Once individuals are in the habit of saving the aim is to keep them saving persistently. Current trends in persistency show that broadly 75 per cent of eligible employees who are currently saving in a workplace pension are persistent savers. Survival analysis trends show savings persistency is marginally higher in the public sector, reflecting the greater stability of pension provision in that sector[10].

Increasing the amount of savings

The second key objective of the reforms is to increase the amount being saved for retirement.

Despite the decline in pension participation[11], especially in the private sector, trends in total pension saving have remained broadly stable in recent years. In private sector workplace pensions the amount saved per year has fallen from £39.3 billion in 2007 to £35.0 billion in 2011. However, total pension saving per year in public sector workplace pensions has risen over the same period from £31.9 billion to £35.1 billion (in 2011/12 earning terms)[12].

While there is a small risk that employers may reduce or level down contributions for existing members to manage additional costs, research suggests that over 90 per cent of those who make contributions of three per cent or more would not change their scheme or reduce contribution levels for existing members in response to an increase in total contribution costs. Recent trends support these findings, showing only a marginal increase in employees experiencing some form of levelling down, from eight per cent to 11 per cent from 2005–10 in the private sector[13].

To understand the potential offset of savings in workplace pensions by reductions in other forms of saving[14] the total stock of saving will be monitored. In 2006/08 the total stock of net saving for all eligible employees, including those with negative savings (i.e. debt) was estimated to be £3.6 trillion. Of this, pension saving accounts for £1.7 trillion (almost 50 per cent), net property saving accounts for £1.5 trillion (around 40 per cent) and net financial saving accounts for £0.4 trillion (just over ten per cent)[15].

Understanding the wider context

Impact on employers

The reforms are expected to have a greater impact on private sector employers, where pension provision and participation is much lower than in the public sector. Currently, around a quarter (24 per cent) of private sector organisations offer some form of workplace pension, with provision being significantly higher amongst larger employers. However, only ten per cent provide an open scheme in which the employer makes a contribution[16].

[9] DWP Individual Attitudes Survey (IAS, GB), 2009 in *Individuals' attitudes and likely reactions to the workplace pension reforms 2009*. At: http://research.dwp.gov.uk/asd/asd5/rports2009-2010/rrep669.pdf

[10] DWP estimates derived from the ONS unweighted Longitudinal ASHE, GB. Saving persistently is defined as an eligible employee saving in year one, who saves in three out of a four years period. Survival analysis tracks the participation of a cohort of eligible employees saving in year one, year on year.

[11] ONS Occupational Pension Scheme Survey, The regulator's Purple Book and DC Trust, 2007-11.

[12] DWP estimates derived from the ONS ASHE GB. Figures are in nominal terms and include both funded and unfunded pension contributions. ASHE consistently underestimates employer contributions due to problems associated with respondents' access to this information and because lump sum contributions covering more than one employee are excluded. Estimates should therefore be treated with extra caution. ONS does not publish estimates of total savings from ASHE.

[13] Levelling down is the reduction of employer contributions for existing members in anticipation or in order to meet the employer duties. DWP Employer Pension Provision Survey (EPP, GB) 2011, DWP estimates derived from the ONS unweighted longitudinal ASHE, GB.

[14] DWP (2012). *Supplementary review of research relevant to assessing the impact of Workplace Pension Reforms on household savings*. At: http://research.dwp.gov.uk/asd/asd5/report_abstracts/ihr_abstracts/ihr_010.asp

[15] In UK terms, £1 trillion is equivalent to £1,000 billion. DWP estimates derived from the ONS Wealth and Assets Survey (WAS, GB).

[16] Forth, J. and Stokes, L. (2012). *Employer Pension Provision Survey 2011*. DWP.

Overall, the administrative costs to employers as a consequence of the reforms are estimated to be around £480 million in the first year, with ongoing administrative costs of around £150 million per year. The additional contribution costs are estimated to be around £4.0 billion per year, within a range of £2.9 to £4.4 billion (in 2012/13 earnings terms), once minimum contributions have been fully phased in.

The most likely response to the increase in total contributions, indicated by almost half of employers, would be to absorb these costs through a reduction in profits (25 per cent) or as part of other overhead costs (22 per cent). However, around 17 per cent said they would absorb the increase through lower wage increases, 15 per cent through price increases and 12 per cent through workforce re-structure or reduction[17].

For non-members and new employees, just under half (49 per cent) of pension providing employers said that they would use their existing scheme compared with 19 per cent who said they would use NEST. For those employers without a current scheme, almost half (45 per cent) indicated that they would enrol all employees into NEST.

Pensions landscape and charges

There is a trend of decline in open DB schemes[18]. Between 2007 and 2011 the number of occupational DB schemes has fallen from around 7,500 to 7,000 and the number of Defined Contribution (DC) schemes has fallen from around 52,000 to 45,000 in the same period. The decline in DB schemes is expected to continue, regardless of the new employer pension duties. As well as a decline in employer sponsored workplace pension provision, the number of active non-employer sponsored personal pensions has also declined over time from 7.0 million in 2006/07 to 5.6 million in 2009/10.

Provider research shows that the average annual management charge for trust based and contract based schemes varies by employer size. Charge levels are on average 0.71 per cent for trust based schemes and 0.95 for contract based schemes. However, charges are lower for the largest schemes (1,000+ employees) at 0.48 per cent on average[19].

Long-term impact of the reforms

Counterfactual modelling (a view of the pension landscape if the reforms had never happened) highlights the impact of changes in the economy, labour market and pension participation on the success of the reforms. In particular, it shows that it is not until the late 2030s that there starts to be a noticeable effect on aggregate weekly median private pension incomes as a result of the reforms[20]. Analysis using a combination of high and low assumptions shows that, in particular, fund growth and average earnings growth will have a significant impact on median weekly private pension income.

[17] Forth, J. and Stokes, L. (2012). *Employer Pension Provision Survey 2011*. DWP.

[18] ONS Occupational Pension Scheme Survey 2010, The Pensions Regulator Purple Book and DC Trust.

[19] DWP Pension Landscape and Charges Survey 2011: summary of research findings. Available at: http://research.dwp.gov.uk/asd/asd5/summ_index_2011_2012.asp

[20] DWP estimates derived from the Pensim2 model, 2020 to 2100.

The full report of these research findings is published by the Department for Work and Pensions (ISBN 978 1 908523 75 4. Research Report 803. July 2012).

You can download the full report free from: http://research.dwp.gov.uk/asd/asd5/rrs-index.asp

For further information about the Workplace Pension Reforms Evaluation please email: workplacepensions.reformsevaluation@dwp.gsi.gov.uk

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