

The Employment Rights (Amendment, Revocation and Transitional Provision) Regulations 2023: simplifying annual leave and holiday pay calculations under the Working Time Regulations in relation to Retained European Union Law

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| Lead department | Department for Business and Trade |
| Summary of proposal | The proposal is to reform legislation on holiday pay and entitlement, including calculating pay and entitlement for irregular workers based on their actual hours worked and removing the Working Time (Coronavirus) (Amendment) Regulations. |
| Submission type | Impact assessment (IA) – 10 th October 2023 |
| Legislation type | Secondary legislation |
| Implementation date | 1 st January 2024 |
| Policy stage | Final |
| RPC reference | RPC-DBT-5305(1) |
| Opinion type | Formal |
| Date of issue | 27 October 2023 |

RPC opinion

| Rating¹ | RPC opinion |
|---------------------------|--|
| Fit for purpose | Overall, the Department has provided a satisfactory impact assessment (IA) for the proposal. The IA uses appropriate data sources and evidence to underpin the assessment. The SaMBA is sufficient given the proposal is expected to benefit businesses of all sizes. The IA states the Department's intention to complete a post-implementation review (PIR) within five years of implementation. There are some areas for improvement, including demonstrating whether evidence gained from consultation has impacted the estimated costs, further consideration of wider impacts, and a more detailed monitoring and evaluation plan. |

¹ The RPC opinion rating is based only on the robustness of the EANDCB and quality of the SaMBA, as set out in the [Better Regulation Framework](#). RPC ratings are fit for purpose or not fit for purpose.

Business impact target assessment

| | Department assessment | RPC validated |
|---|----------------------------------|---|
| Classification | Qualifying provision (OUT) | Qualifying provision (OUT) |
| Equivalent annual net direct cost to business (EANDCB) | -£81.3 million | -£81.3 million <i>(2019 prices, 2020 pv)</i> |
| Business impact target (BIT) score | -£406.5 million | -£406.5 million |
| Business net present value | £699.8 million | |
| Overall net present value | -£50.2 million | |

RPC summary

| Category | Quality² | RPC comments |
|---|----------------------------|---|
| EANDCB | Green | The EANDCB calculation makes a reasonable distinction between direct and indirect impacts of the policy, consistent with RPC guidance. The IA clearly outlines evidence, data and assumptions used and the uncertainty surrounding these. The IA could be improved by further discussing some assumptions (see below). |
| Small and micro business assessment (SaMBA) | Green | The SaMBA is sufficient for this proposal given that it is expected to benefit businesses of all sizes. The Department suggests micro-businesses should take advantage of free HMRC payroll software to mitigate transition costs. The IA could benefit from considering whether further mitigations are appropriate, and more explicitly considering medium-sized businesses. |
| Rationale and options | Weak | The IA establishes a satisfactory rationale for intervention, outlining the issues with existing holiday pay and entitlement legislation. The IA would benefit from using findings from the consultation to strengthen the rationale. The IA helpfully sets out which proposals were considered at consultation stage, explaining which proposals were dismissed or taken forward as a result, however, the IA is not always clear in explaining how the consultation has informed policy decisions. The IA would also benefit from further exploring non-regulatory options. |
| Cost-benefit analysis | Satisfactory | The IA provides a reasonable level of monetisation, justifying key assumptions and outlines the methodology used. Where monetisation is not possible, the Department has appropriately used breakeven analysis to demonstrate the long-term benefits of the proposals. The IA could benefit from discussing how far evidence from consultation supports the estimates. |
| Wider impacts | Weak | The IA provides some discussion on a limited range of wider impacts. The IA includes appropriately a relatively detailed equalities impact assessment, however, would benefit significantly from further addressing competition, innovation, and sectoral impacts. |
| Monitoring and evaluation plan | Weak | The IA states the Department's intention to complete a PIR within five years of implementation. |

² The RPC quality ratings are used to indicate the quality and robustness of the evidence used to support different analytical areas. The definitions of the RPC quality ratings can be accessed [here](#).

The IA briefly outlines success criteria, potential data sources and metrics. The IA should be improved by providing a more detailed evaluation plan, including further explaining how the success criteria, data and metrics will align. The IA should also provide further detail on monitoring plans.

Summary of proposal

The main pieces of legislation that govern holiday pay and entitlement for workers in Great Britain are the 1998 Working Time Regulations (WTR) and the 1996 Employment Rights Act (ERA). The WTR implement the EU's Working Time Directive (WTD) and therefore are considered retained EU law and are in scope of the 2023 Retained EU Law Act.

The Department identifies several issues with the current EU holiday pay and entitlement legislation, most notably how holiday pay is calculated for irregular workers. In July 2022, the Supreme Court held that the correct interpretation of the WTR is that holiday entitlement for part-year workers should not be pro-rated so that it is proportionate to the amount of work that they actually perform each year. As a result of this judgment, part-year workers are entitled to a larger holiday entitlement than part-time workers who work the same total number of hours across the year.

The IA considers the following options:

- **Option 0:** Do nothing. Carry forward EU employment law on annual leave entitlement as it stands now.
- **Option 1:** Preferred option. Introducing a number of legislative changes to tackle issues of complexity and unfairness in current holiday pay and entitlement law:
 - a. Employers will be able to pay their irregular hours and part-year workers rolled-up holiday pay, calculated as 12.07% (related to the Statutory amount of 5.6 weeks leave annual leave entitlement) of their pay received for work done in a pay period.
 - b. Employers should calculate their irregular hours and part-year workers' annual leave entitlement using an accruals approach: for the statutory entitlement, it would be 12.07% of hours worked in the pay period.
 - c. The Government will remove the Working Time (Coronavirus) (Amendment) Regulations 2020 so that from 1st January 2024 workers can no longer accrue covid related carry over leave.
 - d. The components of pay which are to be included when calculating holiday pay for the four weeks of leave stipulated under regulation 13, currently largely based on case law, will be set out in the legislation, as will be the definition of irregular hours workers and part-year workers, to provide clarity to employers and workers.

The proposed changes are expected to commence on 1st January 2024. The changes affecting irregular hours and part-year workers will apply to leave years commencing from 1st April 2024 onwards.

The IA estimates that all employers of irregular hours and part-year workers will benefit from an annual saving of around £149 million; these workers will lose an equivalent amount. Employers are estimated to incur one-off costs of around £64 million, including familiarisation costs, changing payroll systems, and amending workers' contracts.

The monetised NPV of -£50.2 million consists of the one-off costs and the ongoing transfer from workers to employers. The EANDCB of -£81.3 million consists of the annual transfer to private sector employers, one-off costs, and transition costs.

EANDCB

Identification of impacts

The EANDCB calculation makes a good identification of direct impacts of the policy, consistent with RPC guidance. The policy is expected to be net-beneficial to businesses, largely due to the transfer from workers to employers as a result of moving to an accruals method of calculating holiday pay. The IA explains that it is very challenging to quantify this transfer and helpfully provides a range in estimates to illustrate this uncertainty. Whilst the range is helpful in the light of uncertainties, the IA could benefit from a clearer explanation of the assumptions and sources used to calculate the high, low and mid-point estimates referred to in Table 7.

The IA states that variable shift workers are excluded from these calculations due to data availability. Given that these workers are estimated to represent nearly half of total irregular hours and part-year workers (paragraph 98), the IA could benefit from including illustrative analysis to demonstrate the potential effect on the direct benefit to business if these workers were included. However, given the uncertainty it is reasonable that these workers are not included in the central EANDCB estimate.

The monetised direct costs on business are identified as one-off familiarisation costs with the policy, and transition costs including amending written statements for current workers, amending written statement templates, updating holiday entitlement and pay systems, and familiarisation with these systems changes. The IA usefully disaggregates familiarisation costs by different types of workers, namely those who work regular hours and are therefore less impacted by the proposals and those working irregular hours. The IA could benefit from clarifying whether the familiarisation costs include the time spent disseminating information through organisations and HR resource for answering queries. The IA could also benefit from further explanation as to why using a 52-week reference period for those on sick leave or other statutory leave involves no additional cost to business (paragraph 89).

SaMBA

The SaMBA is sufficient for this proposal given that it is expected to benefit businesses and accruals holiday pay is an enabling reform, so employers would only choose to use it when it benefits them to do so. The Department argues that all businesses, regardless of size, will need to comply with the regulation as this would

undermine the policy objective to simplify the approach to calculating annual leave entitlement and pay.

The IA discuss that due to data availability it is difficult to know whether smaller businesses have proportionately more, or fewer, irregular hours workers than larger businesses. The Department uses LFS data to estimate the distribution of irregular hours and term-time workers, i.e., those impacted by the proposals, by business size. Where possible, the IA helpfully includes tables providing a breakdown of cost by business size, with an explanation of assumptions in the annexes.

The IA states that the cost of updating systems is likely to be similar for all employers regardless of size. Whilst this may be the case, these fixed costs are likely to fall disproportionately on smaller employers. The IA suggests taking advantage of free HMRC payroll software as mitigating transition costs for micro-businesses. The IA could benefit from discussing whether further mitigations could be appropriate for SMBs, for example, an extended transition period.

Medium-sized business considerations

The IA helpfully includes consideration of impacts on medium-sized businesses in the tables breaking down impacts by business size. The assessment would benefit from taking specific account more fully of the Government's widening of presumed exemptions on regulation on businesses with fewer than 500 employees.

Rationale and options

Rationale

The IA establishes a satisfactory rationale for intervention, explaining how the current holiday pay and entitlement legislation is complex and can be challenging for employers to follow, particularly for employers of irregular hours and part-time workers. The intervention aims to reduce the administrative burden on business. The IA states these assumptions on the current system are supported by stakeholder engagement. The IA also states that evidence suggest irregular hours workers are more likely to miss out on their annual leave entitlement and therefore argues that employers of these workers require further clarity on calculating holiday entitlements. The Department argues that the Working Time (Coronavirus) (Amendment) Regulations are no longer needed. The IA provides useful background to the proposal and includes a 'theory of change' diagram (Figure 1); however, this does not include all aspects of the proposal e.g., removing the Coronavirus Amendment. The IA could benefit from developing the theory of change further to include all measures.

The Department identifies the risk that the transition to accrued holiday pay could disincentivise irregular hours workers from taking leave or incentivise them to work longer hours and argue that existing safeguarding will mitigate against this risk. The IA would benefit from using evidence to justify this position, especially given evidence shows these workers are already more likely to not take their full holiday entitlement (paragraph 29). The IA would also benefit from addressing the legal

mechanisms available for workers who are not allowed to take their full holiday entitlement.

Options

The IA explains how two consultations have been carried out on the proposals in the IA (paragraph 33). The IA helpfully sets out which proposals were considered at each consultation, summarises the responses, and explains which proposals were dismissed or taken forward as a result. For example, the Government initially consulted on introducing a 52-week reference period to calculate annual leave entitlement for irregular or part-time workers. This proposal was dismissed after consultation due to respondents concerns over the administrative burden and complexity associated. However, the IA is not always clear in explaining how the consultation has informed policy decisions. For example, the Government decided to remove the Working Time (Coronavirus) (Amendment) Regulations 2020 despite a large proportion of respondents being opposed to the proposal, arguing that there were risks of unintended consequences and concerns amongst employers about the costs of paying off large amounts of accrued leave (paragraph 37.d). The IA should discuss how the negative impacts raised at consultation can be mitigated.

The IA briefly explains that a non-regulatory approach, i.e., improved guidance for holiday pay and entitlement, would not meet the policy objectives (paragraph 38.e.ii). The IA would benefit from further consideration of alternatives to regulation and more developed justification for a regulatory approach.

Cost-benefit analysis

Evidence and data

The IA is based upon a reasonable level of data, using a variety of survey evidence and assumptions used in other relevant IAs. For example, assuming basic familiarisation costs for the proposals are the same as familiarisation time for the proposals to reform Flexible Working Regulations in 2023 (paragraph 58). The IA would benefit from being clear on what evidence these assumptions were based, and whether there is post-implementation information available to support them.

It is not clear from the IA whether assumptions used in the CBA have been revised following consultation. The IA would benefit from discussing how far evidence from consultation supports the estimates, and if/how assumptions have been revised following consultation. The IA would also benefit from presenting any international evidence on the implementation of similar policies where relevant.

Modelling

Throughout the IA, the data and evidence underpinning the modelling is well referenced. The annex helpfully outlines the assumptions underpinning the monetised costs. Where monetisation is not possible, i.e., administration savings, the Department uses break-even analysis to illustrate that a relative low proportion of employers' time over the 10-year appraisal period would need to be saved in order

for the proposals to breakeven. This helpfully illustrates that the proposal is unlikely to be net costly to society over the longer-term.

The IA helpfully acknowledges uncertainties underpinning the analysis, but it lacks a specific sensitivity analysis which could be beneficially included in the risks section.

Wider impacts

Health and wellbeing

The IA provides some discussion on a limited range of wider impacts. The IA briefly discusses the negative impacts of workers being disincentivised to take annual leave under the new system. The IA would benefit from further assessing the potential health and wellbeing impacts for workers who may be disincentivised from taking leave and workers who may be vulnerable to being denied leave.

Workforce impacts

The IA could have also been improved by further assessing the extent to which rolled-up holiday pay might incentivise employers to engage workers on a more casual basis and incentivise certain types of employment contracts. There is also only a limited assessment of behavioural impacts on workers in relation to any disincentives to taking their holiday entitlement from the rolled-up holiday pay option.

Economy-wide impacts

The IA could benefit from a qualitative discussion of the potential impacts on recruitment, retention, job satisfaction and long-term employment relationships. The knock-on effects on productivity and wage levels also merit attention as workers might demand higher wages to offset reduced holiday pay. The assessment could also discuss any disproportionate impacts on seasonal industries such as agriculture and tourism compared to more stable sectors and the extent to which this could lead to marginal shifts in the industrial structure.

The IA could also discuss whether the potential of lower holiday pay costs for business costs would, in a competitive market, translate to more affordable goods and services for consumers or whether workers might demand higher wages instead.

Equalities impacts

Given the nature of the impacts on workers with irregular hours etc, the IA includes appropriately a relatively detailed equalities impact assessment. The IA states that, based on the composition of irregular workers, some protected groups (e.g., women and disabled workers) are more likely to be directly impacted by the proposal (paragraph 145). The IA states these workers are likely to disproportionately benefit from the proposals, however, this statement does not appear to align with the fact that these workers will receive less holiday pay when moving from the calendar year approach to the accrual approach, assuming hours worked remains constant (see Figure 2 for comparison). The IA should reconcile these statements and further assess the likely impact on these groups of workers.

Competition, innovation, and sectoral impacts

The IA states that the proposals should help improve competition and market fairness (paragraph 133), however, this statement lacks justification. The assessment of wider impacts would benefit significantly from further addressing competition, innovation, and sectoral impacts, particularly in view of such irregular working patterns being common in areas such as education.

Monitoring and evaluation plan

The IA states the Department's intention to complete a PIR, within five years of implementation. The monitoring and evaluation plan should state whether the planned review is a statutory obligation. While the IA briefly outlines some success criteria, potential data sources and metrics, there is insufficient detail on how exactly the policy will be evaluated, including how the success criteria, data and metrics will be applied, which is required for final stage. Without this additional detail it will be very difficult for the department to properly carry out a PIR.

The IA states that existing data will be used to broadly monitor holiday pay issues (paragraph 152). However, the IA should provide a more detailed monitoring plan, including timeframes for data collection and how monitoring holiday pay and entitlement issues will be reported.

Regulatory Policy Committee

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